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IMPACT OF THE MONGOLIAN TAX REGIME ON THE COUNTRY'S COMPETITIVENESS

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ABBREVIATIONS

ASYCUDA	Automatic System for Customs Data
CIT	Corporate Income Tax
EPZ	Export Processing Zone
GAMC	Automation Information System in Customs
GDNT	General Department of National Taxation
GDP	Gross Domestic Product
LTO	Large Taxpayer Office
MAT	Minimum Alternative Tax
PIT	Personal Income Tax
TDSC	Tax Dispute Settlement Council
USD	US Dollar
WTO	World Trade Organization

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PREFACE

This report was the product of my visit to Ulaanbaatar from July 26 to October 15, 2004. I have benefited very much from different individuals and organizations during the course of the preparation of this report. I would like to express my deep sense of gratitude to EPRC's Senior Policy Advisor, Dr. Janusz Szyrmer for his meticulous reading and constructive comments on the draft report and guidance throughout my stay in Ulaanbaatar

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This report may be seen in conjunction with EPRC's other documents viz., An Economic Development Strategy for Mongolia: Vision 2020, A Comprehensive Tax Reform Matrix, 100-Day Plan for Economic Growth, Competitiveness and Job Creation, and Preliminary Revenue Estimates.

Rup Khadka
Ulaanbaatar
October 15, 2004

EXECUTIVE SUMMARY

Mongolia has made a big leap during the past decade in the field of taxation. The country has created a broad legal framework and fairly good tax structure. All modern taxes have been put in place; value added tax, corporate income tax, personal income tax, social security contributions, excise duties, customs duties, stamp duties, vehicle tax and immovable property. Import duties are levied with a uniform rate of 5 percent, VAT with 15 percent, corporate income tax with a dual rate of 15 and 30 percent, and personal income tax with progressive rates of 10, 20 and 30 percent. Immovable property tax is levied with a rate of 0.6 percent and excises and export duties are levied on a few selected items with specific rates.

A tax administration has been created under a modern agency concept. It is organized along functional lines and taxpayers have expressed a view that tax administration has improved its working in recent years. It is collecting tax revenue more effectively than many countries around the around. Tax/GDP ratio was 29.7 percent in 2003, which is much higher than the corresponding figures in many developing countries.

There are, however, many issues that need to be addressed in order to make the Mongolian tax system efficient, both administratively and economically, equitable and compatible with sustainable growth. As tax measures have been introduced one after another in a piece meal basis, there are inconsistencies in the tax system. Some taxes such as income taxes and social security contributions are levied at a very high rate while other taxes such as excise duties and immovable property tax are levied with too low rates. Labor is taxed most heavily. Some tax provisions encourage the export of raw materials rather than the sale of materials to local processing industries, which could have produced goods and exported at higher values. As different sectors of the economy are being treated in a different manner, the tax system generates large distortions in the economy and has become horizontally inequitable. The fiscal system is very much centralized, and the tax system is yet to be developed at the local level.

The tax to GDP ratio indicates that Mongolia is one of the highest taxing countries. The high level of taxation is partly due to the high rates of income taxes and social security contributions (almost 60 percent) and partly due to the income tax assessment and collection procedures. Taxpayers are not allowed to deduct several business expenses. There is no provision of loss carry forward/backward, either. Further, companies are required to pay an advance tax each month on the basis of the estimates submitted in the previous income year. Some charges which are commonly classified as non-taxes have also been included in the tax category in Mongolia.

The tax policy and law formulation process is not very participatory, and the level of tax education is rather low. Many pieces of tax laws have been introduced over the years. Income taxes and immovable property tax laws are not only inadequate but do not follow international best practices.

These problems suggest the need for implementation of a comprehensive tax reform package. Now is politically a good time since the parliamentary election was conducted recently. There is also scope to rationalize the tax system in many ways including, allowing full business deductions under the income taxes, providing full input tax credit under VAT, speeding up the VAT refund process, slashing income tax rates, simplifying return submission and tax payment procedures and so on. These measures are not expected to encounter any political difficulties.

It is crucial to adopt reforms in a way that maintains an overall balance in order to establish and maintain a sustainable and sound fiscal system. For example, rate reduction of income

taxes/social security contributions should be accompanied by base broadening, which basically means abolishing tax concessions/incentives granted under income taxes, VAT, customs duties and excises. It will be necessary to broaden the base of excise duties by bringing new items in the tax net. It would also be necessary to raise excise rates on items which are already in the excise net. There is also a need to broaden the base and increase the rate of the immovable property tax. Attempts also must be made to generate more revenue from non-tax sources. Income tax rate reduction should also be accompanied by an increase in the rate of royalties.

Tax reform measures should be announced as a package so that it will be easier to sell a group of reforms. It will be easier to sell the idea of base broadening at a time when the government also can reduce tax rates, allow deductions and simplify tax procedures. If rates are reduced without broadening the tax base, later on it will be even more difficult to eliminate concessions. Attempt must be made to generate revenue at minimum cost. This can be done by selecting less distortionary taxes, designing their appropriate structure and simplifying tax procedures. As the VAT is a neutral tax, it should be developed as the mainstay of government revenue.

Of course, not all measures can be implemented at once. They need to be implemented over a period of time. One has to take into account political realities and administrative capabilities. Revenue implications are equally important, which suggest for a step by step approach. It will be necessary to sequence revenue measures and prepare a long-term revenue strategy. The revenue proposals every year must be introduced in line with the long-term strategy and should help establish a good tax system over a period of time.

Tax provisions need to be included in the laws in a clear manner. There is a need to overhaul the CIT law, PIT law and immovable property tax law, and to amend marginally the VAT law and excise law. It is also important to involve in some ways various stakeholders in the tax policy/law formulation process.

Administrative reform should be an important element of a tax reform package. Design of good laws and rationalization of the tax structure is not an end itself. It must be implemented properly and effectively. For this, it is necessary to reform tax administration. Tax administrators should be trained in the new system. They should be familiar with the rationale of new provisions in order to defend or educate people at large on the new system. It is equally important to educate taxpayers, professionals, lawyers, chartered accountants, auditors and so on. It is also necessary to prepare operating manuals, brochures, and other documents on the tax system and to distribute them on a large scale.

SECTION I: INTRODUCTION

A. Development of tax system

The history of modern taxation is not long in Mongolia. A modern tax system was established in the early 1990s, after the political change at the beginning of that decade. To this end, the General Law of Taxation was introduced in 1993, which established the basis for the imposition of taxes. This law assigned the tax base to the central and local level governments. Central and local taxes are listed in Annex A.

Several taxes were introduced one after another. For example the corporate income tax (CIT), personal income tax (PIT), excise duties, stamp duties, vehicle tax and sales tax were introduced in 1993. Customs duties were introduced in 1991, even before the introduction of the General Law of Taxation. The gasoline and diesel fuel tax was introduced in 1995; land fees were introduced in 1997; the value added tax (VAT) replaced the sales tax in 1998; and the immovable property tax was introduced in 2001. A new law on imposing tax, supervising tax payment and tax collection (originally introduced in 1997) was adopted in 2002.

In addition to these taxes, some other charges such as royalties, forest income, fees or payment for natural resources, which are generally included under the non-tax heading in other countries, are levied as taxes in Mongolia. Besides there are some non-tax sources.

Revenue is divided into two groups: tax and non-tax. As indicated in Annex B, tax revenue constitutes roughly three fourth and non-tax revenue one fourth. Further, as indicated in Annex C, tax revenue is divided into income tax, social security contributions, property tax, domestic trade taxes (VAT and excises) and international trade tax.

Domestic trade taxes provide the bulk of total tax revenue. This is common in many developing countries. But what is uncommon in Mongolia in comparison to many developing countries is the share of income tax, social security contributions and international trade taxes. In many developing countries, international trade taxes still provide the bulk of total tax revenue while income taxes are not that important from a revenue point of view, and social security contributions even do not exist. But in Mongolia, while international trade taxes provide about 8 percent of total tax revenue due to the adoption of a low level of import tariff in the context of more open and liberal trade regime adopted by this country (which is good) income taxes and social security contributions jointly provide about 35 percent of the total tax revenue. This large burden on income taxes and contribution which is high and deleterious to the economic development.

Non-tax revenue contributes about one-quarter of total tax revenue. It comes basically in the form of income earned by budgetary organizations, central bank's profit, dividend, interest and rent. While in general non-tax revenue cannot be used as an effective instrument of revenue mobilization, in the case of Mongolia natural resources have a large potentiality to generate government revenue.

In 2003, Mongolia's tax to Gross Domestic Product (GDP) ratio was 29.7, which is comparable to the tax/GDP ratio of those countries that have a per capita income of more than US\$ 6,000. For example, in 2000, tax/GDP ratio of USA, Japan and South Korea was 29.6 percent, 27.1 percent and 26.1 percent, respectively. Mongolia's per capita income was US\$ 477 in 2003, a level that generally falls in the category of country that has a tax/GDP ratio

below 15 percent. For example, in 2000, tax/GDP ratio in Azerbaijan, India, Pakistan, and Nepal were 18 percent, 11 percent, 11 percent and 10 percent, respectively.

B. Tax related issues

Mongolia has been able to establish and develop a fairly good revenue system in a relatively short period and has been generating revenue more effectively than many other countries that have a much longer history of revenue collection than this country. There are, however, several issues that need to be addressed in order to make the system more efficient, both economically and administratively, and equitable.

- Tax measures have been introduced one after another in a piecemeal basis, without carefully examining their effect on the economy. Tax changes were either intended basically to fix some specific administrative problems or to satisfy some groups. For example, various experiments have been made regarding taxation of gold. While some exemptions granted under VAT were abolished, at the same time new exemptions were introduced. Foreign investors have been granted various incentives, including the exemptions of VAT and customs duties on their imports, which are hard to justify.
- There is a lack of balanced approach. Tax provisions are too liberal in some areas while too conservative in others. For example, Mongolia has moved very fast in the field of customs duties reform, by adopting a uniform low rate of 5 percent. On the other hand, even basic business expenses are not deductible under income taxes, which are subject to high rates.
- Mongolia's tax to GDP ratio indicates that it is one of the highest taxing countries. This may be clear from the comparison of tax/GDP ratio with similar, developing and advanced countries. High level of taxation is partly due to the high rates and partly due to the tax assessment and collection procedures. For example, until 2003 the top rate of PIT and CIT was 40 percent, which was reduced to 30 percent in 2004. On top of it, social security contributions are set at the rate of 29 (or 30 or 31) percent (19 or 20 or 21 percent, depending upon the nature of work, on employers, and 10 percent on employees). Taxpayers are not allowed to deduct several business expenses. There is no provision of loss carry forward/backward, either. Further, companies are required to pay tax each month on the basis of the estimates already submitted in the previous income year.
- Different sectors of the economy are being treated in a different manner. For example, there is different tax treatment for labor and capital, big and small companies, import and domestic products and so on. As a result the, tax system generates large distortions in the economy and has become horizontally inequitable.
- The fiscal system is very much centralized. Policy and administration of so-called local taxes is totally central, while revenue from these taxes goes directly to the local budget. On the other hand, assignment of the tax base to the local governments does not seem to be proper. Tax levied on persons, such as income tax, inheritance and gift tax are not good members of the local tax system. While the personal income tax was taken out from the list of local taxes and added to the list of national tax in 2002, inheritance and gift tax has still been grouped as a local tax, although this tax has not been implemented yet. Similarly, taxes on natural resources may be central rather than local.
- Many pieces of laws have been introduced over the years. Not only there is a separate law for each tax, but often there are two laws governing the same tax. Similarly, there are two laws of a general nature: the General Tax Law, and the Law on Imposing Tax, Supervising, Tax Payment and Tax Collection. Further, tax provisions have been spread in

many other non-tax laws, sometimes inconsistent. Many laws have been amended several times during a short period of time. It is not easy to obtain an overview of the overall tax system. For example, the tax appeal system is governed by at least 7 laws. On the other hand, some laws, particularly income taxes and immovable property tax laws are very brief. Tax administration faces problems in day-to-day work due to inadequate provisions. As these laws do not contain adequate provisions, tax officials cannot respond to the queries of taxpayers properly. Some taxpayers take undue advantages of the insufficiency of the law. Further, these laws do not follow conventional structure.

- Some charges which are generally classified as non-taxes in other countries have also been included in the tax group in Mongolia.
- While the tax administration has been established under a modern agency concept, tax collection procedures, such as payment of tax on the basis of the budget already submitted last year, are influenced by socialist concepts. Exposure to good policy and best administrative practices is limited.
- Tax policy and the law formulation process are not very participatory, and the level of tax education is low.

C. Approach to tax reform

The above discussion indicates the need for restructuring the overall tax system and strengthening and reorienting tax administration. A comprehensive tax reform package needs to be introduced. Now is politically a good time since the parliamentary election was conducted recently. Coalition partners, who have committed to unity, have made several commitments during the election, and people have many expectations and aspirations. There is also scope to rationalize the tax system in many ways, including allowing full deductions under the income taxes, providing full input tax credit under VAT, speeding up the refund process, slashing income tax rates and social security contributions, simplifying return submission and tax payment procedures, and so on. These measures should not encounter significant political difficulties. There are several politically popular things to give to taxpayers.

However, it is also crucial to maintain an overall balance in order to establish and maintain a sustainable and sound fiscal system. For example, rate reduction of income tax/social security contributions should be accompanied by base broadening, which basically means abolishing tax concession/incentives granted under income taxes, VAT, customs duties and excises. It will be necessary to broaden the base of excise duties by bringing new items in the tax net and raising excise rates on items which are already in the excise net. It is also necessary to expand the base of immovable property tax and raise its rate. Attempts also must be made to generate more revenue from non-tax sources. These reforms should be announced as a package so that it will be easy to sell overall reforms. It should be easy to sell the idea of base broadening at the same time as reducing tax rates, allowing deductions and simplifying tax procedures. If rates of income taxes and social security contributions are reduced without broadening the tax base, later on it will be even more difficult to eliminate concessions. Similarly, tax rate reduction should be accompanied by an increase in the rates of excise duties, immovable property tax and royalties.

Of course, not all measures can be implemented at once. They need to be implemented over a period of time. One has to take into account political realities and administrative capabilities. Revenue implications are equally important, which suggest for a step by step approach. It will be necessary to sequence revenue measures and prepare a long term revenue strategy. The

revenue proposals every year must be introduced as per the long-term strategy and should help establish a good tax system over a period of time.

Administrative reform should be an important element of a tax reform package. Design of good laws and rationalization of tax structure is not an end itself. It must be implemented properly and effectively. For this, it is necessary to reform tax administration. Tax administrators should be trained in the new system. They should be familiar with the rationale of new provisions in order to defend or educate people at large on the new system. It is equally important to educate taxpayers, professionals, lawyers, chartered accountants, auditors and so on. This must be supplemented by several operating manuals, brochures, and other tax education programs.

D. Review of earlier studies

Several studies have been carried out by foreign consultants in recent years on specific aspects of the Mongolian tax system or tax administration. Main recommendations of the available studies are given in Annex K to this report. Of the previous studies: a study carried out by Arthur Mann in 2000 covered several aspects of the Mongolian tax system and tax administration. Daniel R. Deitz's study, which was carried out in 2001, focused on the structure of the corporate income tax law and also recommended measures for the improvement in training of tax officials. Graham Holland and Sandor Somodi prepared an extensive report on strategic management, information flows and the operation of the large taxpayer office in 2002.

The year 2003 witnessed many reports. Brains Wurts analyzed various aspects of VAT in detail. Richard Krever examined several aspects of the corporate income tax law. James M. Otto reviewed the fiscal issues taking Copper Mine as a case; Kevin C. Cheng analyzed Growth and Recovery in Mongolia during Transition. William F. Amole prepared a report on Mongolian Mining Sector Competitiveness and the Use of Stability Agreements.

E. Focus of the current study

The current study goes beyond previous studies. It not only provides general concepts but also prescribes specific policy, legal, procedural and administrative measures for a comprehensive tax reform. It specifically intends to examine the effect of taxation on businesses. It must be remembered that tax policy, tax legislation, tax structure and tax administration all can affect businesses in many different ways. It is, therefore, necessary to examine all these aspects in order to see the effect of taxation on business. This study answers such questions as: Is the Mongolian tax system efficient, economically and administratively? Is it investment friendly? How does it affect the competitiveness of the economy? What measures need to be introduced to fix problems?

To answer these questions, an attempt was made to review the existing tax policy, tax laws, and tax structure, and to analyze the procedures of various taxes. Meetings were conducted with tax collectors, taxpayers and other groups in order to understand the working of the tax system in real life. Similarly, several discussions were held with politicians and policy makers on broader tax policy and administration issues. A gist of opinions of various individuals we met is given in Annex J.

SECTION II: INCOME TAXES (CORPORATE AND PERSONAL)

A. Revenue contribution

Income taxes are the second largest source of tax revenue in Mongolia. They provide about 20 percent of total tax revenue, 16 percent of total revenue and about 6 percent of GDP. As indicated in Table 2.1, in 2003, income taxes provided 81,812 million Tugrigns. Out of this, 52,730 million Tugrigns was collected from CIT and 29,082 million Tugrigns from PIT.

Table 2.1: Composition and Trend of Income Tax Revenue

Source	1999	2000	2001	2002	2003
Amount (Tugrigns in Million)					
Personal income tax	12,593.4	14,830.0	20,675.8	26,165.1	29,081.9
Corporate income tax	26,450.9	47,996.1	43,828.7	46,268.8	52,729.9
Total income tax	39,044.3	62,826.1	64,504.5	72,433.9	81,811.8
Percent of total					
Personal income tax	32.3	23.6	32.1	36.1	35.5
Corporate income tax	67.7	76.4	67.9	63.9	64.5
Total income tax	100.0	100.0	100.0	100.0	100.0
Income tax revenue as percent of					
Total tax revenue	21.5	24.1	19.7	20.2	20.2
Total revenue	15.75	18.15	15.00	15.42	15.54
GDP	4.2	6.2	5.8	5.8	6.0

Source: Based on data in Appendix Table A2.

Of the total income tax revenue, like in many other developing countries, CIT provides on average roughly two thirds while PIT one third of the total income tax revenue.

B. Rate structure

(a) High and Dual CIT Rates

CIT is levied with dual rates as follows:

Table 2.2: Rate Structure of CIT

Income level (in Tugrigns)	Rate (in percent)
0 to 100,000,000	15
Above 100,000,000	30

Until 2003, the top rate was 40 percent, which was high for a developing country like Mongolia, particularly when one takes into account the high level of social security contributions. The problem of high and dual CIT rates in Mongolia has been discussed widely and well recorded. This issue was also raised during our meetings with various people.

Unlike the common practice of levying a flat rate of CIT, Mongolia levies progressive rates, as it is commonly done under the PIT in other countries on an equity ground. It is, however, difficult to find rationale for a progressive rate structure of CIT as companies are simply a

"conduit" through which income flows to individuals who are their ultimate owners. Since on a priori grounds, one cannot say that the taxable capacity of the shareholders of the bigger companies is higher than the shareholders of the smaller companies the size of the company does not matter from the point of view of taxable capacity or equity.

Some people mentioned that the reason for the introduction of dual rates was the promotion of small business. Mongolians did not have capital to run business when political change occurred in the early 1990s. As there was a need to encourage small businesses, a lower rate was introduced targeting them, and for the same reason some Mongolians still think that it is necessary to maintain a lower rate on small business. This might be true to some extent, but overall costs of dual rates to the economy are enormous. For example, small or medium companies would not be encouraged to grow larger; on contrary big companies would be encouraged to split up into smaller ones, not for any economic reasons but to lower tax liability. This issue was raised during our meetings with several groups. Manager of a business group reported that one business, managed by the same group of people, has been divided into 10 different units (Electronics, Food and Beverages, Carpet Manufacturing, Departmental Store, construction and so on) not for any economic reasons but just to avoid the higher rate of CIT. It is common with many other companies too. As the difference between the lower rate and higher rate is very big, any business would be tempted to split to avoid paying the higher rate of CIT (see Annex D), which does not only create unnecessary cost to the economy for example costs relating to registration, book keeping, return submission, tax payment etc. of separate entities but also Mongolian economy is deprived of the benefits of economy of scale.

On the other hand, CIT law does not have any anti-splitting rules, which are again not easy to administer. In the absence of such rules, the rationale of the progressive rate structure is undermined. Dual rates system rather generates inequity in the tax system, which is the case now in Mongolia. As there is a gross tendency among the businesses to split, only those who for some reasons cannot or do not want to split their business are discriminated against since they have to face unfair competition. Thus the dual rate system has been discouraging companies to grow, which is not good for the sustainable development of the Mongolian economy.

The story does not end here. Progressive rate structure penalizes an efficient company that generates more profit as it has to pay more tax, vis-à-vis, an inefficient company that generates a little profit. In such a situation even an efficient company may be tempted to show more expenses and less profit in its accounts in order to lower its tax liability.

Further, progressive rates make tax administration complicated, resulting in higher costs to both taxpayers and tax collectors.

The above discussion clearly indicates the need to unify CIT rates. This has already been realized by many Mongolians. To this end, the Mongolian government of Revolutionary Party narrowed down the gap between lower and higher rates, by bringing down the top rate from 40 percent to 30 percent in January 2004 and discussions are going on for the further reduction in the higher rate. On the other hand, the Motherland Democratic Coalition indicated its intention in its Election Manifesto 2004 to go for a uniform CIT rate. So gradually a national concession is being build up for the unification of CIT rate. This approach has been carried further recently by the coalition government in its minimum common programs. This is an appreciable step.

There is still a dilemma that if we reduce the top rate of CIT considerably in the context of unification of rates, there will be a substantial reduction in the CIT revenue since a few big companies that are subject to top rate of CIT pay bulk of the CIT revenue. On the other hand, if we fix the unified CIT rate at a high level it would increase the tax burden on small

businesses substantially which would either force some businesses into bankruptcy or compel to switch into an unincorporated form of business, which is not easy to tax or go even underground which has already been a big problem in Mongolia. This indicates the need to fix the uniform rate of CIT not at a very high level. Further, increase in the taxation of companies due to the increase in the existing lower rate should be accompanied by a reduction in the social security contribution. Further, introduction of a more liberal expenditure deduction system where all business expenses would be deductible and loss would be carry forward to offset in the future would mitigate the impact of increased tax liability due to the increase in the current lower level CIT rate.

It should also be mentioned that not only the number of CIT rates, but its level is also a problem. The upper rate of CIT was 40 percent until 2003, which was high for such an economy. It is to be noted that the rationale of CIT itself has been questioned over the years since it induces undesirable and unnecessary changes in organizational form, financial structure and dividend policy. High rates only add fuel to the flame. They give incentive to the taxpayers to avoid and/or evade tax. They discourage taxpayers to work more, to save more and to invest more. This indicates that high rates are detrimental to economic growth. That is why the CIT rate has been significantly lowered in many countries in the recent years in order to minimize costs of taxation to the economy and encourage the investment. It has been realized in Mongolia as well, and the top rate has been lowered from 40 percent to 30 percent. It is desirable to bring CIT rate down further.

Rate adjustment may be done in a phased manner. For example, higher rate could be reduced first to 25 percent and then this rate and lower rate of 15 percent could be unified at 20 percent so that other revenue measures would generate additional revenue to compensate revenue loss from rate adjustment over medium term.

A revenue neutral uniform rate of CIT does not look feasible. This is because tax burden is too high when one combines income taxes with social security contributions. Attempts should be made to compensate revenue loss due to CIT rate adjustment from other measures such as base broadening of income taxes and VAT by abolishing exemptions, introducing excise duty on beer and increasing excise rates on vehicles, increasing the base and rate of immovable property tax, rationalization of non-tax revenue and strengthening tax administration which are discussed in detail later in this report. Besides, adjustment in CIT rate would avoid many distortions and cost to the economy, leading to sound economic growth, expansion in economic activities, and enlarge tax base, thereby resulting in higher tax revenue in the future.

Recommendation

- Unify rates and levy it in the neighborhood of 20 percent in a phased manner.

(b) PIT Rate

PIT rates have been high as well. Like CIT higher rate, top marginal rate of PIT was 40 percent until 2003. It was lowered down to 30 percent in January 2004. The existing rate structure is as follows.

Table 2.3: Rate Structure of PIT

Income bracket (in Tugrigs)	Tax rate (percent)
0 – 2400000	10
2400001 - 4800000	20
Above 4800000 -	30

During our meetings with various people, some indicated the need to reduce the top rate further, while others consider that the existing structure seems to be reasonable. What is a reasonable PIT rate depends upon the social security contributions. If the rates of social security contributions are very high, there may not be a need to levy PIT on employment income at all. On the other hand, PIT rate could be fixed at a reasonably high level in the absence of a social security contribution system. So the level of PIT should be seen in conjunction with the level of social security contributions. Tax burden in Mongolia is too high when one takes into account the combined burden of PIT and social security contributions.

It must be remembered that differentiation in the CIT rate and top marginal PIT rate generate distortions. For example, if CIT rate remains much below the top marginal rate of PIT, taxpayers would be encouraged to create companies instead of proprietorship firms, not for economic reasons but to lower the tax liability. Similarly, under such a situation, taxpayers would be encouraged to keep their savings in the form of profits retained in the corporate sector. In order to avoid tax induced distortions, the difference between the top marginal rate of PIT and the CIT should not be high. Like in the case of CIT, reduction in PIT rate may be implemented in stages, depending upon the revenue requirements and state of broadening the tax base and strengthening tax administration.

Recommendation

- The number and level of PIT rate should be reduced in a phased manner and finally a uniform rate may be levied in the neighborhood of 15 percent.

(c) Special rates on specified sources of income

Some sources of income have been subject to the following special rates:

Table 2.4: Special Rates Applicable to some Sources of Income

Type of income	Special rates
Income from disposal of an immovable property	2 %
Royalties	10 %
Dividends and gains of shareholders, and interest	15 %
Income from lotteries, various games, and video show	40 %
Purchases of inventory and raw materials except raw wool, cashmere and skin	3 %
Remuneration from scientific, literary and artistic work, copyright, invention and innovation, design and other identical income	
• up to 5000000 Tugrigs	5 %
• on additional income	10 %
Income from remuneration for artistic and sports performance	10 %
Income from licensing fees	10 %
Income of a citizen derived in respect of the provision of services performed overseas such as medical service, artistic performance and scientific research and advertising, unless otherwise provided by the International agreements	10 %

Tax rate will be 20 percent on above-mentioned income if a permanent resident does not provide the employer with the tax identification number.

Non-residents are required to pay tax at the rate of 20 percent on dividend, interest, royalties, leasing payment, and income of technical and other services, and transfer of profit by permanent establishment. High rates on non-residents are likely to encourage foreign subsidiary or permanent establishment to escalate costs, show low profit and pay less tax. In the absence of transfer pricing and other anti-avoidance rule, it will be difficult for the weak administration to check leakage in revenue.

Recommendations

- As the rate structure applicable to specific sources of income is complicated and confusing, it requires simplification.
- Mongolia has continuously expanding its international tax treaty network. It has already completed treaties with 33 countries and considering completing treaties with other trading partners as well. In this context rates applicable to non-residents may be made compatible with treaty rates.

C. Basic allowance/tax credit

Mongolia differs from the rest of the world by not providing any allowances under its PIT. It must be noted that there is a common practice to provide allowances in a variety of ways such as basic allowances, allowances for spouse, children, aged persons and so on, which are generally fixed amounts and are deducted from the total income before it is taxed.

Of the allowances, basic allowances are universally adopted. The basic allowance is simply a slice of income received free of tax by every taxpayer. As it relieves a large number of low income earners from the tax net, it simplifies tax administration. This system was adopted by Mongolia also until 1997 when complain was lodged to the court against the basic allowance system on the ground that the system deprives Mongolian citizen from the right of paying tax. In response to this, the basic allowance system was abolished. As a result, even very small income earners are required to comply with the tax and the tax administration has to administer them. It increases both cost of collection and compliance cost without any corresponding revenue gains. This indicates the need to reintroduce the basic allowance under the Mongolian PIT. The allowance could be fixed in such a way that the minimum subsistence level of an average family can be relieved from PIT. This will be particularly important in the context of imposition of a uniform PIT rate, much higher than the current lowest rate of PIT. Other such factors as per capita income, equity and administration may be considered at the time of determining the level of basic allowance.

The basic allowance, however, should not be fixed at a very high level which would erode the tax base, leading to a revenue loss. Further, large income groups would get more benefit from the large amount of basic allowance than the lower income groups due to the applicability for lower marginal rate to high income. This will, however, be not an issue once Mongolia adopts a uniform PIT rate.

Alternatively, a reasonable amount of tax credits may be provided instead to relieve lower income groups from the burden of income taxation. Under the tax credit system, every taxpayer gets the same amount of relief irrespective of the level of income. Since the tax credit system relieves lower income group from the burden of taxation and improves equity, it is more attractive than basic allowance system from an equity point of view. The credit system, however, does not solve administration problem of petty income earners, who would still be required to file income returns to the tax office. This is, however, not a big problem when employees with only one employer are not required to file a return. Employer can calculate the annual tax liability of their employees and can deduct the credit amount through total tax

liability. While Mongolia does have a tax credit provision, the existing tax credit of 48,000 Tugrigs (US\$ 42) a year (this amount was 36,000 Tugrigs from April 1997 to June 2001) seems to be too low. This needs to be increased.

Recommendation

- Either basic allowance system should be reintroduced or tax credit amount should be increased.

D. Tax withholding:

As in many other countries, Mongolia makes use of withholding tax mechanism to collect revenue from specified sources of income. Sources of income subject to withholding tax and applicable rates are given below:

Table 2.5: Withholding Rates

Source subject to withholding tax	Withholding rates
For Residents	
Royalties	10
Dividends and gains of shareholders and interest	15
Income from lotteries, various games, video show etc.	40
Purchases of inventory and raw materials except Raw wool, cashmere and skin	3
Salaries, wages and allowances, other than main employment	10
For Non-Residents	
Dividend, interest, payment for security, royalties, leasing payment, income from the use of tangible or intangible properties, income of technical and other services, transfer of profit by Permanent Establishment	20

Any person making disbursements of the above mentioned incomes is required to withhold income tax at the time the disbursement is made which needs to be transmitted to the treasury within 7 working days. The withholding tax system is advantageous from the following reasons:

- Since tax is collected from relatively a small number of payers of income instead of a large number of receivers of income, it simplifies tax administration.
- Since the large number of taxpayers does not have to file tax returns it minimizes both compliance costs and administrative costs.
- As the tax is collected from the employers etc. who are relatively organized and whose number is relatively smaller than that of employees etc. the system helps minimize tax evasion.
- Withholding system also produces a steady flow of revenue to the government.

However, the withholding system should be limited to income where it is not sure that tax will be collected. It should not be levied on such items as purchases of inventory and raw materials, which is currently subject to 3 percent withholding tax. This system does not provide check to ensure that withheld tax was paid by withholders to the government. There is

a lack of controlling mechanism for the leakage of such tax revenue. In case of business income attempts must be made to make the payers of income liable to provide information. Where flow of income is documented, there is no need for withholding. It is, therefore, necessary to establish reporting requirement instead of withholding tax in the case of business income. So follow up on both reporting and payment should be done instead of levying withholding taxes on a variety of incomes.

Recommendations

- Withholding rates seem to be high. It is particularly so in the case of rates applicable to non-resident. They need to be made comparable to the rates mentioned in the tax treaties, which are on average 10 percent.

E. Taxation of dividends

Companies pay CIT on their income. After-tax income of a company is either retained or distributed in the form of dividends to its shareholders. Dividends are taxed at the rate of 15 percent when distributed to residents companies (dividends distributed to individuals are exempt until the end of 2004) and at 20 percent when distributed to non-residents. The company income is taxed twice: once at the company level and again at the shareholder level, resulting in double taxation.

There are different opinions regarding the tax treatment of dividends. Some think that since a dividend tax inhibits the development of the corporate sector, which is necessary to develop company culture to mobilize capital and organizational skill that is a key to the economic development of Mongolia, dividends should be exempt totally from the PIT. However, others think that although exemption of dividend prevents double taxation of company income, the system does not provide check to ensure that income tax was paid at the company level. As a result, equity shareholders may effectively pay no or low tax rates on their income from their equity investments.

Further, exemption of dividend does not provide benefit to the foreign investors as it looks in the outset. This is because dividends paid to non-resident shareholders may be taxable upon receipt in the home country of a foreign investor. If his home country offers tax credits for taxes paid on dividends in Mongolia, a tax break in Mongolia will merely be transferring revenue from the Treasury in Mongolia to the treasury of the home country of foreign investors without providing any additional investment incentive to the foreign investors. However, it does not happen so if the home country of a foreigner investor has adopted a provision of tax sparing under which scheme the amount of foreign tax spared such as in Mongolia is credited against domestic tax. Further, exemption of dividends would weaken the bargaining power of Mongolian tax administration during negotiation of tax treaty. This indicates the need to levy a withholding tax on dividends paid to non-residents. Taxation of dividends distributed to non-resident actually will not make any difference in tax burden of a foreign investor until the Mongolian tax rate remains equal to or lower than the tax rate in foreign investor's home country where he pays tax on his world wide income, including Mongolian sources income and gets credit for the tax paid in Mongolia.

In the case of dividends distributed to the residents, different methods could be adopted to avoid or reduce the double taxation. One way to avoid double taxation is to adopt an elective final withholding tax on dividends where shareholders can file and take credit for withholding tax on dividends. Alternatively, rate of dividend tax could be lowered as it is done in many countries including Nepal to minimize double taxation of dividends. Or, Mongolia can limit dividend tax to dividends distributed from exempt income only.

Recommendations

- Of the three alternatives viz; elective final withholding, tax on dividend distributed from exempt income and reduction in the dividend tax rate, on an administrative ground the last one seems to be the most attractive.

F. Deductible business expenses

Mongolia has adopted an itemized system of deductions for the purpose of both CIT and PIT. Under this system, deductible expenses are specified in the law. For example, under the Economic Entity and Organization Income Tax Law (CIT Law) direct expenses such as wages, salaries, all kinds of material expenses, excise duties, immovable property taxes, vehicle tax, social and health insurance premiums, interest, royalties, rent etc. are included in the list of deductible expenses. Similarly, under the Personal Income Tax Law, cost related to materials, water, energy, fuel petroleum, payment for interest on bank loan, leasing, social and health insurance instalment, transport facilities, vehicle tax, excise and tax payment for use of natural resources etc. are deductible.

No deduction is allowed unless a particular expense is specifically included in the list of deductible expenses. While such a system ensures uniform treatment of all taxpayers, particularly in a country like Mongolia where tax administration is young and weak and accounting system is not well established, it is not possible to provide an extensive list of possible expenses of all types of businesses. For example, even such obvious items as customs duties have not been included in the list of deductible items under both PIT and CIT laws. Similarly, property taxes are not included in the list of deductible items under the PIT law. While VAT paid on purchases by VAT registrants is not a deductible item since taxpayers can claim it as an input tax credit, it is a cost to those businesses which are not registered under the VAT. Similarly, pre-operating expenses have not been mentioned in the list of deductible expenses. That expense, which are not included in the list of deductible expenses, are disallowed, which means that it may so happen that some real business expenses are disallowed.

Maximum limit has been fixed for certain expenses. For example, total combined costs relating to advertising, promotion expenses, and training of staff should not exceed 10 percent of gross taxable income as per the CIT law. This limit was originally fixed to check misuse by the company directors who were in the early 1990s very powerful when all Mongolians used to have share of companies in papers but in reality only directors were powerful, and used to send their children, relatives or friends abroad for training at the cost of companies. While it might have been reasonable to fix such rules in order to control the misuse at that time but now situation has changed. So the cap for deductible expenses is no longer relevant. Now there is a need to focus on human resource development in order to increase productivity and efficiency of companies, and training is considered crucial for this purpose. Similarly, advertising also has been considered as one of the important factors for the promotion of business. So advertisement expenses need to be made deductible as well.

Some items which are included in the non-deductible lists such as capital repairing expenses, damages caused to third parties, transportation and food allowances, gift and donations provided to others, meals for guests etc. are not in line with the normal modern practices. Repair and maintenance expenses that are made to prevent decline in values of assets should be considered as deductible expenses. Donations are also not allowed as deductions. However, neither the complete band nor full deductions of donations is desirable. Donations which are provided for good cause such as for the support of natural calamities, public schools, Mongolia Children Fund, if created, etc. may be made deductible while other donations may not be deductible. There is also a practice to fix some ceiling which may be useful in the

Mongolian context as well. Similarly, as hospitality relating particularly to foreign buyers helps promote exports, it may be treated as deductible expense.

Under the modern income tax system there is a practice to allow taxpayers to deduct all business expenses related to their taxable income. Such a system does not require a list of deductible expenses in the law. Since Mongolia is heading towards the modernization, it should adopt the modern concept of deductible expenses. Preoperational costs can either be deducted immediately or amortized for certain years.

Recommendations

- It is necessary to adopt a liberal system deductible expense. All businesses expenses relating to taxable income should be made deductible. Similarly, some expenses, such as donations which are not business related expenses but are incurred by businesses, should be allowed as deductions, of course, with some limit.

G. Depreciation

Cost of capital nature, i.e., cost incurred in acquiring assets (both tangible and intangible) that have a useful life of more than a year is not deductible. These assets are used to generate income for several years. Their value decreases over the years due to the wear and tear. This loss in value of assets is deductible in computing taxable income over the useful life of assets. By doing so, the cost of an asset is spread over a period of time when it is used. Full deduction of capital costs in the year of purchase would lead to an understatement of taxable income in the year of purchase and overstatement of income in the following years when the capital assets are used. So instead depreciation on capital goods used in earning taxable income is deductible during the period of useful life of an asset.

Like other provisions, Mongolian tax laws do not make detailed provisions relating to depreciation. While the CIT law has fixed the useful life of depreciable assets and specified straight line method of depreciation, the PIT law is silent regarding any depreciation provision except specifying depreciation as allowable costs. In practice, depreciation rules prescribed under the CIT law are followed for PIT also.

There are different methods of depreciation such as declining balance method and straight-line method. Declining balance method recognizes that assets depreciate more in the earlier years while straight line method presumes that assets depreciate by an equal percentage of the original value during the useful life. While CIT law specifies straight line method, PIT law is silent on this matter.

There is a practice to fix depreciation rate for each asset separately or to fix rates for a group of assets. The former system is known as the itemized system while the latter system is called the pooled system. Under the itemized system, useful life and depreciation rates for each asset are given separately while under the pooled system; all assets of a similar nature are put in a group and treated as a single asset for the purpose of depreciation. Mongolia may switch from an itemized system straight line method to a pooled system with diminishing balance method of depreciation since the latter system is easier for both taxpayers and tax administration. Depreciable assets may be divided into four to five groups and depreciation rates can be fixed on the basis of the estimated useful life of the asset and be included in the tax laws or regulations. It must be noted that depreciation rates, which are set too low, constrain capital investments and impede cash flow, while high rates lower tax liability. So a reasonable balance needs to be maintained. Special depreciation allowances can be provided for plant and machinery that are used for double or triple shifts, since they involve high wear and tear. Such a system may encourage high utilization of asset. This, however, would invite some

administrative complications. As discussed latter on, accelerated depreciation may be provided to certain sectors.

Recommendations

- A pooled system of depreciation with diminishing balance method (straight line method for intangible assets) may be adopted.

H. Loss carry-forward/backward

There is no provision for the set off of business losses under the Mongolian income tax system. It must be remembered that some time businesses may face a situation where expenses may be more than income. That is why there is a common practice around the world to provide some sort of relief for losses incurred by a taxpayer. But Mongolia lacks such a provision. While there has been provision for the loss carry forward for three years under the Mineral law, it has not been recognized by the tax officials. This is definitely not an investment friendly situation, which imposes high tax burden on such risk taking business where profit is highly uncertain. It inhibits economic growth. It is, therefore, necessary to introduce liberal rules relating to the tax treatment of losses in order not to discourage more risky investment and to make the tax system growth oriented.

So Mongolia should introduce provisions relating to set off of business losses under both PIT and CIT systems. To this end, taxpayers should be allowed to carry over the loss to offset it against profits in the future years. Such a provision would promote such businesses where taxpayers bunch all expenses in the beginning but receive income at a later stage. While unlimited carry forward may be desirable from an economic point of view, limitation is desirable on the fiscal and administrative ground since unlimited carry forward of losses creates scope for abuse by so called loss companies. This means taxpayers should be allowed to carry forward losses up to certain period, at least five years. However, in the case of big power/infrastructure projects, loss carry forward may be allowed for 10 years.

Some businesses such as banking, finance companies and insurance business where risk and uncertainty are higher than other businesses, may be allowed in addition to carry forward, to carry back losses to offset it against profits in pervious five years. However, this provision may not be necessary when banks and other financial institutions are allowed to deduct loan loss provisions.

It will be necessary to fix quarantine rules in a broad term for specific source of losses. For example, foreign losses can be offset against foreign income only. Foreign sources losses again can be set off only with the income of a foreign country where the loss has occurred.

Recommendations

- Loss carry forward should be allowed, at least for five years.

I. Tax treatment of leasing

Both PIT and CIT laws lack detailed provisions relating to taxation of leasing. While PIT law mentions lease-related costs as deductible costs it is not adequate to handle tax matters properly. As leasing has been developing as an important source of financing in Mongolia, where many companies do not have enough capital to outright purchase of equipment, necessary provisions need to be made regarding the tax treatment of leasing.

Leases can be either an operating or a finance lease. Under the operating lease, the asset is not capitalized in the lessee's accounts but remains as an asset in the lesser's accounts. On the

other hand, since a finance lease is treated as a purchase in the lessee's accounts, the asset is capitalized in its accounts. This means that under the operating lease, the lesser is regarded as the owner of the leased asset while the lessee is regarded as the owner under the finance lease.

Under the operating lease, lesser is entitled to deduct lease related costs and depreciation allowances while lease payments are treated as taxable rental income to the lesser. On the other hand, lessee can deduct the rental payments for asset and is allowed to deduct any cost paid by him for the operation of the leased asset.

On the other hand, under the finance lease, lesser may be regarded as the financier, who is supposed to have sold the leased asset to the lessee, only interest part of rental payment is considered as the taxable income and cost related to the leased asset is deductible while lessee is allowed to deduct depreciation allowances, interest part of the rental payment and the operating cost.

Recommendations

- Detailed provision relating to tax treatment of leasing need to be introduced.

J. Excessive tax incentives

Tax incentives have been widely used in Mongolia to achieve various goals. They are provided in the form of exemptions, tax holidays, tax deductions, rebates etc and are briefly stated in Annex E. Some incentives are provided to attract foreign investment, some are targeted to attract investment in specified field, and some are targeted to attract investment in certain geographical region while some are still intended to promote export.

International experience indicates that tax incentives could not produce desirable results and have largely been misused without generating satisfactory development in the country's industrial arena. For example, tax holidays generally encourage the establishment of certain industries that either vanish or change names, ownership or place of business once the tax holiday period expires. Further, since industries are not likely to have any profits in the beginning, exemption of profit from income tax in the initial years is not attractive particularly for industries with a long gestation period. In contrary, industries can not carry forward their losses incurred during the tax holiday period. Besides, tax holidays would be attractive to foreign investors only when they are allowed to credit the amount of tax exempted by Mongolia against their domestic tax liability, which is calculated on the basis of worldwide income, including the Mongolian source income. In the absence of the tax treaties, foreign investors cannot credit the amount of tax exempted in Mongolia against their total tax liability, meaning that the amount of tax forgone by the Mongolian government would simply be transferred to the Treasury of the investors' home country and foreign investors will not get any advantage from the exemption policy of the Mongolian government.

On the other hand, plethora of incentives brings considerable erosion of the tax base. Further exemption of some sources of income from income tax brings inequity since these sources are favoured against others. It brings inefficiency since resources are likely to be diverted from taxed to untaxed sectors in response to tax. Exclusions also provide loopholes for tax evasion and complicate tax administration. They also create transfer pricing problem and invite unnecessary pressure from the business community for further incentives. They are also source of corruption.

Incentives given to attract foreign investment some times simply divert local resources abroad and re-invited in the form of foreign investment in the name of friends, partners etc. During our meetings, one business manager frankly said that they would have run one of their

businesses without foreign investment had there been no special tax incentives to foreign investment. Such incentives create unfair competitions.

Similarly, income tax is not an effective way to promote export. There are other fiscal tools which need to be adopted in order to promote exports. For example, every attempt should be made to relieve export from the burden of commodity taxation so that Mongolian products would not be less competitive in the international market due to taxation. It demands a timely and efficient VAT refund mechanism for the exporters. Similarly a duty draw back system or a bonded ware house mechanism needs to be in place in order to eliminate the burden of customs duties on exports.

During our meetings it has also been mentioned that location targeted incentives, which are provided to develop under developed areas, have also not been effective due to the lack of proper definition of such areas.

Depreciation can be used to encourage investment. Several special depreciation measures have been adopted by different countries to achieve certain policy objectives. For example, there is a practice to use accelerated depreciation. Under the accelerated depreciation method, as an incentive, taxpayers are allowed in the early years of the useful life of the assets to depreciate at a higher rate than is justified on purely technical or economic grounds. Accelerated depreciation means postponement of tax in proportion to investment made by company concerned. This allows companies to use money in other areas for a certain period.

Liberal deprecation provision should be accompanied by liberal system of treatment of losses. If losses cannot be adjusted, then liberal deprecation will not have any meaning. So taxpayers should be allowed to carry forward losses for sufficiently long period. So Mongolia should switch from tax holidays regime to liberal deprecation and carry loss adjustment system.

It is true that Mongolia requires attracting investments, including foreign investment, which comes with technical know-how, managerial capability and wide market. But for this to happen, the country needs to adopt the right policy. In the fiscal front, overall low tax rate, simple and transparent tax structure and tax procedures, motivated and service minded tax administration, and an impartial and effective system of appeal are considered right tools than incentives to specific industries. As tax rates go down concessions becomes irrelevant, and tax holidays are considered not necessary or even justified. Liberal provisions relating to allowable expenses, depreciation and carry forward or back of losses are adopted to promote investment and economic development now a days.

Recommendation

- Effective tax incentives are lower rate across-the-board in stead of tax holidays or rebates to specific sector, liberal expense deductions system, reasonable depreciation system, sufficiently long period of loss carry forward and taxation on the basis of actual transaction.

K. Avoidance of international double taxation:

Tax treaties which are adopted to avoid international double taxation play an important role in attracting foreign investment. While international double taxation also can be avoided through unilateral relief by adopting measures to avoid international double taxation in the domestic tax laws, bilateral agreements provide more assurance to investment than unilateral provisions, which can easily be withdrawn or changed at any time. Such an assurance is very much necessary to attract and maintain stability in the investment. In general, provisions of the bilateral treaty override the provisions of the domestic laws relating to taxation.

Mongolia has adopted unilateral relief and bilateral agreements in order to avoid the problem of international double taxation. There is a need for Mongolia to enter into bilateral agreements with other countries also. It is necessary to develop technical capacity on tax treaty matters for the purpose of implementing them at times of need.

L. Presumptive taxation/minimum alternative tax

Mongolia has been making maximum use of presumptive taxation, particularly in the case of those businesses where it is administratively difficult to calculate net income. Under this system, specified businesses are required to pay lump sum amount, depending upon their location. For example, handmade printings, smith service, repairers of radio, TV, watch, shoes, cloths etc., photo service, car washing, small trading etc. are subject to presumptive tax. Tax rates are fixed on a lump sum basis, as per the geographical areas, which are divided into three groups. For example, rates fixed for Ulaanbaatar are the highest and while lowest for the least developed area. In addition to simplicity, these rates provide incentive to generate more income since effective tax rate decrease with the increase in productivity. Such rates need to be adjusted in line with inflation in order to prevent a fall in revenue in real terms.

However, no turnover or other criteria have been fixed for this purpose. This means that even the persons who have big turnover but are engaged in these businesses would pay presumptive tax. This would not only result loss in revenue but would make tax system inequitable. This was also pointed out by some bankers during our meetings. In order to correct the situation, it would be necessary to fix some short of limit on the basis of the annual turnover for example 24 million Tugrigs for the eligibility of the business to come under the presumptive regime. Further, the use of the presumptive base should be limited as it is not desirable from several reasons.

There is also a practice to levy a minimum alternative tax (MAT) that could provide a good backstop to the CIT. MAT can be levied on income, assets or gross receipts. For example, Argentina, Ecuador and Mexico levy such a tax on gross assets while Costa Rica levies it on gross fixed assets. On the other hand, Bolivia, Colombia, Panama, Peru and Uruguay impose such a tax on net assets. France and the Francophone African countries levy a minimum tax on gross receipt or turnover. In USA, such a tax is levied on adjusted income. In India, MAT is levied on book profit, which is defined as the net profit as shown in the profit and loss account. The main reason for the imposition of MAT is to levy minimum tax on those who try to take advantages of loopholes to pay little or no tax.

Recommendations

- Presumptive should be limited to those income where it is extremely difficult to impose normal tax, i.e. very small enterprises. Rates should be fixed a little higher than the normal tax regime so that taxpayers would be encouraged to come under the normal regime. However, it should not be fixed so high to force taxpayers to go underground.
- MAT can be considered at a later date, depending upon the level of implementation and the taxpayer's compliance after the implementing of a comprehensive tax reform package.

M. Inflation adjustment

Income brackets, basic allowances, credits, business expenses etc. which are fixed or will be fixed in money terms are affected by inflation. If they are not adjusted for inflation, they are eroded in real terms over the years due to inflation. As a result, those previously exempt are now subject to tax and those who were already in the tax net move up into higher tax brackets

without any increase in their real income. This bracket creep phenomenon, which erodes real after tax personal income, increases the tax burden on fixed income groups such as on wage and salary earners who are generally taxed more effectively than the other income groups.

Inflation-induced distortions across periods can be insulated or minimized either by discretionary measures such as a periodic revision in the amounts of allowance, credits, expenses etc. fixed in monetary terms in line with the rate of inflation or through indexation. The latter, however, is not an easy job. Even a simple system of bracketed adjustment for inflation by applying the inflation percentage determined by the central bank to any amount expressed in monetary term, would make the life of both taxpayers and tax collectors difficult. So it is desirable to make some rough adjustments in income taxes through discretionary measures in order to minimize the effect of inflation. This should be accompanied by some other such administrative measures as strengthening collection function, reducing time lag, enhancing penalties for non-payment and applying them on time, and improving appeal system.

N. Installments

Tax is paid on the current year basis. Mongolia is not an exception to it; there is a common practice around the world to pay current year's tax in a few installments, which is generally determined on the basis of last year's tax amount. If a business is likely to have big changes in its transactions and consequently in tax liability this year due to some specific reasons, then the business may report to the concerned tax office and pay tax accordingly. However, during our meetings, taxpayers reported that they have to pay tax each month according to the budget submitted last year for this year, irrespective of their situation of profit or loss this year. If they incur loss at the end of the year, tax amount is not refunded. It is carried forward. It creates cash flow problem to the businesses.

Taxpayers are required to pay advance tax on the basis of monthly tax payment schedule prepared on the basis of budget submitted last year. They have to pay advance tax on a monthly basis (quarterly basis in case of an annual taxable income up to 500,000 Tugrigs.) and submit return on a quarterly and an annual basis. While the system assures a regular flow of income to the government, it increase costs to the taxpayers.

Recommendations

- Taxpayers may be asked to pay current year's tax liability in three or four installments and submit an estimated return some time in the first half of the year and final return within specified time after the expiry of the year.

SECTION III: DOMESTIC TRADE TAXES

A. Background

In Mongolia, domestic trade taxes are prime revenue raisers as they should be. As these taxes can reach the large section of population, including lower income group, on whom it is difficult to impose income taxes, they are broad-based. Since they do not require a rigorous assessment procedure they are comparatively easy to administer. Consequently, these taxes provide about 45 percent of total tax revenue in Mongolia.

VAT and excise duties are major domestic trade taxes. These taxes jointly generated revenue of 180,600 million Tugrigs in 2003. The status of VAT revenue is given in Table 3.1 while that of excise duties in Table 3.2

B. VAT

B1. Revenue

VAT provides about 30 percent of total tax revenue, 23 percent of total revenue and 9 percent of GDP. VAT revenue is divided into domestic VAT and import VAT. Like in many developing countries import VAT constitutes more than half of total VAT revenue.

Table 3.1: Composition and Trend of VAT Revenue

Sources	1999	2000	2001	2002	2003
Amount (in Million of Tugrigs)					
Domestic	28,941.6	30,182.1	43,798.3	40,696.0	47,821.5
Imports	31,418.6	46,036.5	60,395.5	77,992.2	94,251.4
Refund	0	0	0	0	20,387.6
Total	60,360.2	76,218.6	104,193.8	118,688.2	121,685.3
Percent of total					
Domestic	47.9	39.6	42.0	34.3	39.3
Imports	52.1	60.4	58.0	65.7	77.4
Refund					-16.7
Total	100.0	100.0	100.0	100.0	100.0
VAT as percent of					
Tax revenue	33.3	29.2	31.7	33.0	30.1
Total revenue	24.4	22.0	24.2	25.3	23.1
GDP	6.5	7.5	9.3	9.6	8.9

Source: Based on data in Appendix Table A2.

B2. Structure

Of the domestic trade taxes, VAT is the most important tax, which is broad based, neutral and transparent. The tax is levied on all goods and services, except exempt specifically by law. The tax is collected at all stages in the production and distribution process. The registration threshold is 10 million Tugrigs. Tax rate is 15 percent while exports are zero rated. Overall structure of VAT looks fine.

Tax credit and refund are the key features of VAT, which make this tax different from other forms of sales tax. VAT is a tax that is based on value addition and since this concept is translated into practice through the medium of tax credit or refund, the taxpayers should be entitled to adjust the entire tax paid in connection to his/her taxable transaction. If tax credit

and refund are not implemented effectively the complete benefits from VAT cannot be availed of.

Mongolian VAT law does not prevent taxpayers taking credit of VAT paid on the purchases relating to their taxable transactions except a few cases as discussed latter on. The law also stipulates that if the tax paid by the taxpayers in relation to their taxable purchase is larger than the tax collected on their sales, the excess can be adjusted in the following manner:

- Credit the excess against next VAT payments that are due on the following month, quarter, or year;
- Credit the excess against other forms of taxes which shall be transferred to the state central budget as provided by law and that are due;
- Refund the tax of taxpayers except manufacturer-exporter from the budget quarterly.

Large taxpayer office is responsible for the VAT refund. Taxpayers who are in excess credit position can apply, together with the tax invoices, for refund to the local tax office. Tax office, in turn, checks documents related to refund claims and forwards it to the large taxpayer office. Monitoring division of the large taxpayer office, if finds necessary, also carries out checks. While there is no time limit fixed separately for the processing of refund at the local tax office and the large taxpayers office, large taxpayer office has to submit the refund claim to Ministry of Finance for its approval within 15 days from the date of the refund claim was made to the local tax office. If refund cannot be processed within this time, then the large taxpayers office informs the concerned taxpayer about it. According to tax officials, Ministry of Finance generally takes one month to approve refund claims. According to the VAT law tax authority should deposit thirty percent of the total amount of VAT revenue collected to a specific fund for the purpose of VAT refund.

Diplomats and diplomatic missions apply for refund to the large taxpayer office directly together with relevant purchase invoices. Large taxpayers office process these requests and sends within 15 days to the Ministry of Finance for its approval.

The process is different in the case of foreign aided projects. Ministry of Finance approves the list of foreign aided projects that are subject to special refund process and sends the list to the large taxpayer office. These projects get special invoices from the large taxpayer office, which are printed in three copies with different colors. They are serially numbered and the large taxpayers office keeps record of distributed invoices. These projects submit invoices to their sellers. The sellers fill in three copies at the time of sales. Sellers keep one copy and returns two copies to the project. Project has to submit statement of its purchases together with one copy of each invoice to the large taxpayer office. This office, in turn, submits the report of each project to the Ministry of Finance.

B3. Issues

B3.1. Poor functioning of the tax credit/refund system

VAT credit/refund mechanism has not been working efficiently due to some legal, procedural and implementation problems. The voluntary registration does not seem to be easy. It is necessary to have at least 80 percent taxable transaction of the registration threshold in order to be eligible for the registration. This means that a potentially big business would not be able to register unless and until its taxable sales reaches 8 million Tugrigs. Such a denial to register start-up business does not match with the basic VAT principle. On the other hand, VAT paid on the stock at the time of registration cannot be offset. As a result, there will be double taxation on the stock that exists on the day of VAT registration. Similarly, no input tax is allowed on the VAT paid on imports or purchases of a motor car, its components and spare

parts. As motor cars are also used for the personal use of owners or employees, there is a practice to limit input tax around the world. For example, only 50 percent of VAT paid on the import or purchase of vehicle can be claimed. Denial of input tax credit on vehicles purchased for resale or lease is against the principle of VAT. This leads to double taxation.

On the other hand, while as stated earlier there has been a provision for the adjustment of excess credit with other tax liability, carry forward or claim for a refund, it is not clear which of the conditions should apply under which circumstances. It creates confusion and difficulty in the implementation of the adjustment of excess credit.

Besides, during our meetings, most of the businesses reported that the refund system has not been working well. First of all, the process itself is lengthy since refunds are to be approved by the Ministry of Finance. Longer the process of refund mechanism larger is the potential problems and delays. The government officials are not that keen in accelerating the refund process. This is common in many other countries as well.

If a taxpayer cannot avail of the tax credit/refund, it works against the essence of VAT. In that case VAT becomes a turnover tax, which is onerous to business and has been severely criticized and abandoned due mainly to the following reasons:

In the absence of an effective system of tax credit/refund, the tax has a pyramiding effect, where the effective rate of tax increases as the commodity passes along the chain of distribution. The tax paid at an earlier stage and shifted forward increases the cost of the latter stage by the amount of the tax. Conventionally, traders increase their sale price by some percentage mark-up in order to provide, *inter alia*, for profit. Hence, profit margin is also increased on the tax amount since the cost at a latter stage includes the tax paid at an earlier stage. It goes on cumulating until the retail level. The more the transactions before retail sale, the larger the element of pyramided tax in retail price. Pyramiding results in the government getting less revenue than what the consumers actually pay in the form of tax.

Not only this, since VAT is collected at different stages, poor functioning of credit or refund also results in cascading. Since the base at each later stage includes tax at all preceding stages tax is imposed upon tax. This leads to cascading effect. This is explained with the help of an example given in Annex F.

Further, tax cascading and pyramiding lead to vertical integration, i.e. the tax provides an incentive to firms to produce their own inputs used in production instead of purchasing them from independent suppliers. By doing so, firms easily avoid taxes because they do not have to pay tax on inputs which they produce themselves for their own use. In economic terms this is non-optimal result. Under such a situation, economy is deprived from the advantages of specialization and economy of scale. This also further makes it difficult to refund the exact amount of tax levied on exports, which is another undesirable result.

That is why conventional view was to levy domestic trade taxes only on final goods to ensure, *inter alia*, efficiency in taxation. These taxes are ultimately paid by consumers. A tax on inputs does not reduce the tax burden of the final buyers in any way; in fact, it increases burden. An input tax stimulates producers to change their choice of inputs to avoid taxes and this leads to less efficient choice of inputs.

Unfortunately it was not always easy to distinguish between inputs and final goods under other form of goods and service taxes. For example, sugar is a direct good and is also an input for the production of biscuits. So in practice it tends to be difficult to relieve inputs completely from domestic trade taxes, except under the VAT because some of the raw materials, capital goods etc. have multiple uses. But luckily it is not the case with VAT.

Under this tax all tax paid on the purchase is deductible from the tax collected on sales. There is no need to classify what are inputs and what are not under the VAT, thereby effectively relieving inputs from the burden of taxation. But if its credit/refund mechanism does not work, then it also becomes like a turnover tax.

B3.2 Large exemptions

Currently, various goods and services or transactions are exempted from VAT for various reasons as follows.

Social reasons

- Educational services;
- Medical services;
- Art, culture and physical culture services;
- Services by a religious organization;
- Funeral services;
- Services for mitigation of the accident aftermath.
- Special purpose appliances for handicapped people;
- Humanitarian and grant aid goods bought through the grant aid provided by the governments and non-governmental organizations of foreign countries, international and charity organizations;
- Blood, blood products and organs to be used for treatment purposes
- Sale of apartment and or part of it.
- The renting of accommodation in a building as a place of residence or abode;

For the development of industry/tourism/ agriculture

- Imported machinery, equipment, materials, raw materials, spare parts, gasoline, diesel fuel, food and personal items for employee needs, in support of activities related to crude oils provided in an Agreement entered with the Government based on principles of products sharing in crude oil industry
- Equipment and heavy machinery to be used and assembled for technological purposes in production by a business entity with foreign investment which has made an investment into priority industries and export goods manufacturing.
- Tour operating activities to foreign tourists.
- Primary raw material produced in Mongolia from agriculture, forestry and hunting

Administrative reasons

Financial services:

- Exchanging currency;
- Banking services, such as the receipt or transfer of, or any dealing with, money, any security for money or any note or order for the payment of money and the operation of any savings account;
- Insurance services, reinsurance and registration of property;
- the issuance, transfer or receipt of any securities, shares, and underwriting of such securities;
- The making the advance or the granting of credit;
- The provision or transfer of an interest on social insurance fund;
- Any services in respect of fees for bank interest, dividend, credit guarantees or insurance contract;
- The financial leasing.

Other exemptions

- Passengers baggage for personal use;
- Goods imported for use of diplomatic missions or international organizations residing permanently in the territory of Mongolia;
- Goods, jobs and services purchased in the territory of Mongolia for work needs of diplomatic missions and consular offices residing in Mongolia, if goods, jobs and services purchased for the needs of diplomatic missions and consular offices of Mongolia in foreign countries are exempted from tax in respective countries;
- Service by government organizations
- Any weapons, technical appliances imported for needs of defense, police, and state security, labor correction institutions, and law enforcement;
- Personal use passenger vehicle/not more than one/ of individuals who were appointed to work in diplomatic missions or consular offices residing in foreign countries or in inter-governmental international organizations for period of more than one year and who is return back to the country permanently .
- Sold gold

It is obvious that large exemptions have resulted in a considerable loss of revenue. One, however, does not know to what extent the purposes, for which exemptions have been given, have been realized in practice. Now a day exemptions are not considered as effective means of achieving intended objectives such as equity or promoting certain activities any way. On the other hand, exemptions bring several undesirable and unintended results which are briefly pointed out below:

- Tax exemptions affect the choices of both producers and consumers. Exempted goods and services become more attractive to consumers than their taxed counterparts than market forces warrant. This brings inefficiency both in production and consumption under competitive conditions.
- Exemptions also complicate tax administration and create inconvenience to taxpayers. This is because the latter have to keep separate records of taxed and tax exempt items and the former has to check these records thoroughly. Taxpayers often apply for tax exemption which increases the paper work of tax administration. Sometimes tax administration and the Ministry of Finance have to face undue pressure from some influential persons or organizations. It may not only increase paper work but also result in a considerable loss of revenue.
- Tax exemptions open up loopholes both for tax avoidance and evasion. Exemptions granted to foreign investors are also disputable. Because untaxed materials imported by foreign investors might be misdirected since there is lack of policing to prevent the diversion of untaxed goods. During our meetings some business also reported that some businesses have been set up under the name foreign investment just to save VAT and other taxes.

Such negative aspects of exemptions have been recognized in Mongolia. As a result, such exemptions as passenger transportation services by public transport means, advocacy, and notaries' services, citizen status registration, and archive services, fire extinguishing and natural disaster handling services, property acquired by privatization etc. which were exempt originally have been removed from the list of exemption over the years. However, some new exemptions such as tour operators, sold gold, equipment and heavy machinery to be used and assembled for technological purpose in production by a business entity with foreign investment which has made an investment into priority industries and export goods

manufacturing, and personal vehicles by specified employees have been included in the exemption list.

B3.3 VAT is charged on the sale of business as a going concern

VAT is charged on the sale of business as a going concern. While it is necessary to do so if the buyer is not a VAT registrant, who may be asked to be registered in fact, it only creates cash flow problem if buyer is already registered under the VAT.

B3.4 Insufficient input tax credit provisions for mixed transactions

There are no sufficient rules regarding the input tax credit in case of mixed supply. This may lead at time inappropriate treatment of input tax credit or even may invite conflict between taxpayers and tax officials.

B3.5 Lack of tourist refund scheme

Mongolia has not adopted yet the tourist refund scheme. While there are other a few examples around the world, which do not have such a scheme, introduction of such a scheme is necessary to encourage Mongolia's export.

B3.6 Uniform tax period for all businesses

Tax period is one month for all businesses, including small businesses. It incurs high compliance costs in the case of small business and high cost of collection on the part of tax administration, without much corresponding revenue gains.

B3.7 Annual return

Taxpayers are required to submit an annual return. Under VAT, the case for having an annual return is weak. VAT is a transaction-based tax reported and paid in the taxable period when the transaction occurred. Moreover, a system of both annual and monthly returns is time consuming and costly for the administration and businesses alike.

B4. Prescriptions

B4.1 Broadening the tax base

VAT is more efficient or neutral than other form of goods and service based taxes. This means the same amount of revenue can be generated from VAT with less cost than other taxes. So government should make every attempt to develop VAT as the main stay of government revenue. In this context, first item to be considered is the broadening the base of VAT, legally and administratively. In order to broaden the VAT base legally, it is necessary to examine the exemption list.

Overall exemptions should be kept minimum. It is true that industrial development has a vital role to play in the process of national development. But it is quite often said that tax exemption is not a suitable method for the encouragement of industries. VAT concessions are hardly a suitable method of encouraging foreign investment, either.

VAT exemptions should basically be given on an administrative ground. Those items that are extremely difficult to bring into the tax net from an administrative point of view such as financial services should continue to be exempted. Similarly, some goods and services may remain exempt on social grounds. For example, educational services relating to formal education such as school/colleges/university courses may remain exempted for some time to come. Other exemptions should be exempt. We recommend an immediate abolition of the following exemptions:

- Exemptions provided to the imports of foreign investors
- Exemptions provided to the tour operators
- Exemptions provided to the import of cars by Mongolians returning from abroad by servicing diplomatic mission or other similar organizations.
- Exemption provided to the financial leasing

Other exemptions should be abolished in a phased manner.

B4.2 Provide credit on vehicles

Taxpayers should be allowed to claim a full input tax credit in the case of vehicles purchased for resale or lease. In other cases, they should be allowed to claim 50 percent input tax credit.

B4.3 Input tax on stock at the time of registration

New registrants should be allowed to claim an input tax credit on stock at the time of registration if the stock was purchased within one year from the date of registration and is supported by proper invoice. They should declare the stock on the day of registration, which, if tax administration thinks necessary, can be verified.

B4.4 Input tax credit in the case of mixed transactions

It is necessary to introduce sufficiently detailed provisions relating to input tax credit in case of mixed transactions. VAT paid on any input that is exclusively used for taxable transaction should be deductible fully. On the other hand, VAT paid on any input that is exclusively used for exempt transactions should not be creditable fully. VAT paid on any input that is used in both taxable and tax exempt basis, should be allowed on a pro-rata basis.

B4.5 Sale of business as a going concern

VAT should not be charged on the sale of a business if the buyer is registered. The latter can be made liable for the payment of tax on such a business.

B4.6 Voluntary registration.

Start-up businesses should be allowed to register even if turnover does not reach to the level of 8 million Tugrigs. Similarly voluntary registration should be permitted to other businesses also. Of course, tax administration should have full authority to control any bogus registration.

B4.7 Streamline refund procedures

It is necessary to streamline refund process. Exporters should be defined broadly than the existing concept of manufacturer-exporters. For example, for the purpose of VAT any business can be considered as an exporter when its exports exceed fifty percent of its total transaction. A quick refund should be provided to the exporters in order to make Mongolian products competitive in the international market. An immediate refund is necessary in case of exporters because as they do not collect any tax on their sales (exports), they will not have any thing to adjust. So if refund is not granted immediately exporters will face cash flow problem, which should be avoided. Refund process should be simple. Of course, tax administration should check those documents that support that the exports have been made and input tax liability was incurred by an exporter.

In the case of local sales, the excess input tax credit can be adjusted with other tax liability or be carried forward first which can be adjusted with output tax collected in the following month(s). Unlike exporters, local sellers will have some output tax to adjust the excess credit within the following one or two tax periods. It might take one or two months to get refund any

way. So carry forward provision is beneficial for both taxpayers and tax collectors. This is because taxpayers do not have to claim for refund and tax officers do not have to process refund. It saves both compliance costs and cost of tax collection. If the excess credit is not adjusted within 6 months, then taxpayers can claim for a refund.

Refund is one of the core functions of the tax administration. So General Department of National Taxation should be made fully responsible for the processing and approval of refunds.

It is necessary to develop a brochure/guideline on refund for tax officials, taxpayers and donor community and organize orientation program for the concerned parties to educate them on the refund system.

B4.8 Tourist refund scheme

Mongolia may introduce a tourist refund scheme in order to promote its exports.

B4.9 Longer tax period

A longer period may be introduced for the small vendors in order to reduce their compliance cost and also lower the cost of tax collection. Further, as longer tax period provides small businesses opportunities to hold tax revenue collected from their buyers for a longer time, it may stimulate small vendors to register.

B4.10 Annual return

The system of annual return should be abolished. Instead, the tax administration should monitor non-filers and create a computerized assessment for each non-filer during each tax period when the return is not received.

B4.11 Rate

In Mongolia, some people think that the current rate of VAT is too high. This may be true when one compares Mongolia's VAT rate with the VAT rates of some Asian countries, but it is not high by world standard. World's average rate of VAT is 16 percent. It must also be noted that there is a general trend around the world to raise the VAT rate and reduce the rate of income tax and customs duties. Mongolia has already reduced the rate of customs duties drastically. Now it is time to reduce the rate of income taxes, both CIT and PIT and abolish some social contributions. It must be noted that the same amount of revenue can be generated through VAT than many other taxes, including income tax with less cost. VAT is a neutral tax. As VAT does not favor capital against labor or *vice versa*, this tax does not bring unnecessary changes in the production techniques. Similarly, as the total burden of VAT depends on the total final price, not on the proportion of value added generated at different stages, it does not bring unnecessary changes in the channel of distribution. As VAT paid by VAT registrants is either credited or refunded, it does not constitute cost elements of businesses. It is therefore not necessary to apply profit margin on the input VAT. Exports are relieved from the burden of VAT by means of zero-rating of exports. Because of all these reasons VAT produces less cost to the economy than other taxes. Besides, VAT is levied on both imports and domestic products. Further, VAT is paid by national as well as foreigners. That is why there is a growing trend around the world to rely more and more on VAT for revenue purpose in both developing and developed world. Mongolian government also should adopt a policy to develop VAT as the main stay of government revenue and should not reduce the rate of VAT.

B4.12 Threshold

Some Mongolians consider that the existing VAT registration threshold may be lowered so that the number of taxpayers and tax revenue can be increased. However, we think that the existing registration threshold of 10 million, Tugrigs which was fixed in 1998, has been decreasing each year in real term due to inflation. Besides, given the weak tax administration, it is not desirable to bring a large number of small vendors into the tax net. These vendors pay tax on their purchases any way. They do not pay VAT on their value added only, which may not be important when one considers the compliance costs and cost of collection of administering them. Due to their exclusion from the VAT net, tax administration can concentrate on big fish, which is more productive than chasing a large number of pretty vendors. So the registration threshold should not be reduced.

C. Excise Duties

C1. Revenue

Excise duties generate about 15 percent of total tax revenue, 11 percent of total revenue and 4 percent of GDP. As indicated in Table 3.2, in they provided 58, 915 million Tugrigs in 2003.

Table 3.2: Composition and Trend of Excise Revenue

Source	1999	2000	2001	2002	2003
Amount (in Million Tugrigs)					
Domestic vodka	11,159.2	15,891.7	23,187.9	20,399.2	18,856.0
imported vodka & cigarettes	3,698.6	4,470.0	3,065.0	3,543.0	3,678.8
Imported beer	0	0	3,118.9	2,888.6	3,307.2
Car	3,054.0	7,245.3	7,332.0	6,028.2	10,549.6
fuel and diesel	8,819.4	13,404.9	16,626.2	18,266.3	21,254.1
Domestic cigarettes	0	0	0	196.0	1268.9
Total	26,731.2	41,011.8	53,330.0	51,321.3	58,914.6
Percentage					
Domestic vodka	41.7	38.7	43.5	39.7	32.0
imported vodka & cigarettes	13.8	10.9	5.7	6.9	6.2
Imported beer	0.00	0.0	5.8	5.6	5.6
Car	11.4	17.7	13.8	11.8	17.9
fuel and diesel	33.0	32.7	31.2	35.6	36.1
Domestic cigarettes	0.0	0	0.0	0.4	2.2
Total	100.0	100.0	100.0	100.0	100.0
Excise revenue as percent of					
Tax revenue	14.7	15.7	16.2	14.3	14.6
Total revenue	10.8	11.8	12.4	10.9	11.2
GDP	2.9	4.0	4.8	4.1	4.3

Source: Based on data in Appendix Table A2

Of the excise revenue, traditional excise careers viz. alcoholic beverages and tobacco products provide about half of the total excise revenue while gasoline and vehicle generate rest of the excise revenue.

C2. Structure

Excise duties can be levied on both imported as well as domestically produced goods. Currently, they are levied on the following items:

- All kinds of alcohol;
- All kinds of tobacco;
- Gasoline and diesel fuels; and
- Passenger's vehicles;

However the following goods are exempted from excise duties:

- Exported goods produced within the territory of Mongolia;
- Domestically produced spirits distributed to food factories for the production of hard alcoholic beverages and also for medical use and veterinary medicine;
- Domestically produced beer and home-made liquor distilled from milk;
- snuff tobacco
- Duty free alcohol and tobacco imported for personal use under the permission of Customs Administration;
- Gasoline (automotive) and diesel fuel imported for oil-related business activities, which are carried out in accordance with an agreement, signed with the Government on basis of the product sharing principle in the oil sector;
- Passenger vehicles (not more than 1) for personal use of individuals who are permanently returning home after having worked for more than 1 year at the diplomatic and consular missions of Mongolia in foreign countries as well as in the Intergovernmental international organizations.

As indicated in Table 3.3, excise duties are levied basically with the specific rates, probably on administrative ground since these rates are considered relatively easier to apply than ad valorem rates.

Table 3.3: Excise Tariff

Items	Rates (USD)
1. Imported private vehicles, year of Manufacturing	
• 0 to 3 years	500
• 3 to 10 years	1000
• More than 10 years	2000
2. Beers distilled from wheat cereals, per liter	0.20
3. Alcoholic beverages with less than 40% vol., per liter	5.00
4. Alcoholic beverages with more than 40% vol., per liter	6.00
5. All kind of wines, per liter	0.75
6. All kind of cigarettes, per 100 pcs	0.30
7. Pipe tobacco, per kg	0.15
8. Gasoline and diesel fuel (per border points of import), per ton	
<u>A. Less than 90 Octane</u>	
Gasoline (with laboratory testified octane content not exceeding 90): Tsagaannuur, Yarant, Borshoo, Burgastai, Tes, Gashuun Sukhait	11
Khankh	17
Sukhbaatar, Zamyn-Uud, Ereentsav	38

B. More than 90 Octane	
Gasoline (with laboratory testified octane content of 90 or above): octane content not exceeding 90): Tsagaannuur, Yarant, Borshoo, Burgastai, Tes, Gashuun Sukhait	12
Khankh	21
Sukhbaatar, Zamyn-Uud, Ereentsav	43
Diesel fuel	15
Tsagaannuur, Yarant, Borshoo, Burgastai, Tes, Gashuun Sukhait	
Khankh	19
Sukhbaatar, Zamyn-Uud, Ereentsav	48

C3. Issues

There are a few issues in the field of excise duties. They are mentioned below:

- Exemptions granted on domestically produced beer does not only have revenue implications but it also brings distortions in the market. It is not WTO compatible, either.
- Although the exemption granted on passenger vehicles for personal use of individuals who are permanently returning home after having worked for more than 1 year abroad in diplomatic missions etc. may not be that serious from a revenue point of view, it is hard to justify them on any ground.
- While specific excise duties may be easier to administer, they are inelastic, inefficient and inequitable. As the revenue does not change automatically with the change in the price of excisable items, specific excise duties are inelastic. Some time they also encourage changing the size, strength etc. of the excisable products not for any economic reasons but to lower the tax liability, leading only to distortions in the economy. Specific excise duties are inequitable as well. This is because in this case both higher-priced and lower-priced items are taxed equally. Cheap goods are penalized more than expensive ones.
- Rate of excise duties are rather low.

C4. Prescriptions

- As excise duties are levied to check consumption of those goods that are socially undesirable, such as alcoholic beverages and tobacco products that also cause negative externality, their rates should be fixed at a sufficiently higher level.
- Since excise is also levied on luxury goods, such as cars, in the perspective of social justice, excise rates need to be raised.
- Excise duties should be levied on domestically produced beer.
- Specific excise duties may be converted into ad valorem duties. A switch from specific to *ad valorem* duties would make tax system more elastic and efficient and would bring more progression in the excise duties since it places a preponderant burden on high priced commodities, generally consumed by the rich. This is true even in the case of a commodity consumed both by the poor and the rich when the income elasticity of demand for it is more than unity, since the rich are likely to spend proportionately more on this commodity.

D. Transport facilities and vehicle tax

Transport facilities and vehicle tax is levied on trucks, buses, passenger vehicles, motor cycles, special purpose automobiles (such as cranes, auto-service and repairing automobiles,

laboratory vehicles, etc); tractors and other vehicles and auto trailers. This tax is paid during state inspection of auto-techniques. It is levied with rates given in Table 3.4

Table 3.4: Rates of Transport Facilities and Vehicle Tax

Types of vehicles	Annual rate (in Tugrigs)	
	In Ulaanbaatar city and Souds of Darkhan Uul and Erdenet Aimags centers	In other Souds
Motorcycle		
2 Wheel motorcycle	2000	1800
3 Wheel motorcycle	3000	2800
Passenger automobile /in Tugrigs per cm 3 of the engine capacity/		
a) up to 1000 cm 3	30	26
b) 1001-up to 1500 cm 3	32	28
c) 1501-up to 2000 cm 3	34	30
d) 2001-up to 2500 cm 3	36	32
e) 2501-3000 cm 3	38	34
f) over 3001 cm 3	40	36
Minibus /with up to 15 seats/	70000	56000
Bus	105000	84000
Trucks		
1/ with capacity up to 1 ton	50000	40000
2/ 1-2 ton capacity	70000	56000
3/ 2-3 ton capacity	90000	72000
4/ 3-4 ton capacity	110000	88000
5/ 4-5 ton capacity	130000	104000
6/ 5-8 ton capacity	160000	128000
7/ 8-10 ton capacity	180000	144000
8/ over 10 ton capacity	200000	160000
Special purpose automobiles	16000	15000
Tractor and other vehicles	14000	11200
Mini tractor	7000	5600

The tax is levied on vehicle registered with the State Registration office irrespective of whether the transport facilities and vehicles are used or not. Once the State Registration Office is notified that a transport facility or vehicle is no longer in use, the tax will not be levied from the next quarter. Similarly, if a taxpayer transfers ownership of vehicle, he will not be obliged to pay tax from the next quarter.

The citizen will have to pay the tax during national technical fitness inspection. In case when a vehicle is imported after the national inspection, the tax for the remaining period of the respective year will have to be paid to the tax authority of affiliation.

A part of the revenue generated from this tax is deposited to the respective local road development fund, as determined by the Government.

Business entities and organizations will have to transfer to the state budget, a proportionate amount of annual motor vehicle tax within 25 of the last month of each quarter and submit annual tax report to the tax authority within February 15 of consequent year. The taxpayer may pay quarterly or annual motor vehicle tax in advance.

E. Gasoline and diesel tax

Gasoline and diesel tax is levied on the production and imports of gasoline and diesel at the following rates:

Table 3.5: Rate of Gasoline and Diesel Tax

Description	Rate (in Tugrigs)
Gasoline	
• Octane: Up to 90 per ton	20,350
• Octane more than 90 per ton	25,700
Diesel Oil per ton	2,140

Gasoline and diesel tax is collected by the national tax administration on domestic products of gasoline and diesel while it is collected by the customs administration on the imports of these products.

SECTION IV: INTERNATIONAL TRADE TAXES

A. Revenue

International trade taxes are less important from a revenue point of view in Mongolia than in many developing countries. These taxes provide about 8 percent of total tax revenue, 6 percent of total revenue and less than 4 percent of GDP. As indicated in Table 4.1, international trade taxes provided 32,654 million Tugrigs in 2003.

Table 4.1: Composition and Trend of International Trade Tax Revenue

Sources	1999	2000	2001	2002	2003
Amount (Tugrigs in Million)					
Import duties	5,852.0	17,152.9	25,991.4	23,767.3	31,065.6
Export tax	3,161.4	5,153.1	1,027.3	825.2	1,588.1
Total	9,013.4	22,305.9	27,018.7	24,592.5	32,653.7
Percent of total					
Import Duties	64.9	76.9	96.2	96.6	95.1
Export Duties	35.1	23.1	3.8	3.4	4.9
Total	100.0	100.0	100.0	100.0	100.0
International trade taxes as percent of					
Tax revenue	5.0	8.6	8.2	6.8	8.1
Total revenue	3.6	6.4	6.3	5.2	6.2
GDP	0.97	2.41	2.92	2.66	3.53

Source: Based on data in Appendix Table A2

Of the total customs revenue as it is common elsewhere, import duties provided almost 95 percent in the recent years

B. Structure

Mongolia joined World Trade Organization (WTO) in 1997 and fulfilled most of the WTO requirements. While under WTO arrangements, average custom tariff could go up to 30 percent (50 percent in case of tobacco product and alcoholic beverages), the country has adopted a uniform tariff rate at a very low level, i.e. 5 percent, except 15 percent on a few specified vegetables viz. potatoes, onions and shallots, cabbages, carrots, and turnips from August 1 to April 1 and on flours from July 1 to April 1 in response to seasonal moment in the flow of goods. Tariffs have already brought down to zero on automatic data processing machines etc. and are planned to bring down to zero on medicine in 2005. Tariff reform has been carried out due also to the agreement with International Monetary Fund.

Customs laws have been more detailed and clear than many other tax laws. They have been compatible with international standard. As per the WTO requirements, necessary arrangement has been made in the laws regarding valuation, appeal, rule of origin, post clearance audit etc. While customs administration prepares annual plan for the post clearance audit, it can select any importers for audit any time, if need arises.

Customs administration has been fully computerized. As Automated System for Customs Data (ASYCUDA) did not work well, Mongolia developed its own Automation Information System of Customs (GAMC), which has been running reasonably well since last two years.

Export duties are levied on a few items such as live stock wool (non processed camel wool and cashmere), non-processed goat or baby goat skins, rough logs, square logs (beams) and woolen materials, scrap black and chromatic metal such as iron, steel, copper, zinc, and aluminum. As indicated in Table 4.2, for simplicity's sake, rates of export duties are fixed on specific basis.

Table 4.2: Rates of Export Duties

Export Duties Description of Goods	Rates (in Tugrigs)
Non-processed camel wool (male), per kg	100
Non-processed camel wool (female), per kg	200
Non-processed (coarse) cashmere, per kg	4000
Non-processed goat or baby-goat skins, per piece	1500
Rough logs per square meter	150000
Square logs (beams), per square meter	150000
Wooden materials, per square meter	150000
Scrap black and chromatic metal: Scrap and waste black metal, metal for re-cycling and steel scraps and casting, per kg	140
Waste and scrap cast iron, per kg	140
Scrap and waste stainless and enhanced steel, per kg	140
Waste railway metal, per kg	140
Iron in casting or in other primary form, raw steel, per kg	140
Other steel in casting or in other primary form, other semi-processed steel products, per kg	140
Metal comprised of processed (drilled, punched) or unprocessed particles or spare parts, poles made of steel sheets, welded steel or iron corners classified iron, per kg	140
Railways, per kg	140
Cooper and zinc melt (brass) , per kg	128
Waste and scrap copper, per kg	1500
Copper nuggets, rods and cuts, per kg	1500
Unprocessed aluminum, per kg	450
Waste and scrap aluminum, per kg	450
Aluminum nuggets, rods and cuts, per kg	350

C. Issues

Mongolia still faces formidable challenges in the field of customs. Valuation is custom's biggest problem. While big companies do not involve in under valuation of their imports, such as there is no valuation problem in the import of crude oil, flour etc. by big companies, other imports, by both companies and individuals face valuation problem. The undervaluation problem is severe in the case of import of second hand cars from China, Korea, and Hong Kong.

Due to the automation facilities, customs administration is in a position to generate detailed information about the imports, including the price of imported goods. On the basis of this, customs administration prepares reference prices, which is reviewed every three months. This list is circulated to field customs offices. Reference prices are indicative, but not officially approved prices. They serve as the basis for the customs inspectors to raise question about values declared by importers.

While such a system of data base helps customs officials to values imported goods properly, it sometimes creates problems also. During our meetings, businessmen cited cases of rejection of invoice value by customs officials, when invoice prices are lower than the reference prices. For example, one Ulaanbaatar based business imported two containers of Pepsi directly from a Russian factory. The factory prices per 0.6 litter Pepsi was 0.34 US \$. Retail price in the local market was 0.70 US \$. Customs officials said that according to their information price should be at least 0.37 US \$. The company said to contact the factory directly if they do not believe invoice price. But the customs officials did not agree. There was a negotiation and finally value was settled at 0.36 US\$.

While importers can appeal to the Customs Head Quarter if they do not agree with the price fixed by a customs inspector, importers generally do not opt for an appeal. This is because when an importer goes for an appeal, customs inspectors do not release goods from customs until a decision on appeal is made, which some time may take two three months. Importers have to pay demurrage charges for keeping goods in the warehouse near the customs. Further, as the goods may be held for long time under the customs jurisdiction, it increases cost of doing business. So importers rather prefer to negotiate with customs inspectors on the value, and pay customs duties on the higher values than the invoice prices, as in the case of above-mentioned business. Such a system affects business in many different ways as indicated in Table 4.3

Table 4.3: Effects of Under Valuation and Over Valuation

Description	When customs is levied on invoice price (real situation)	When customs officers raise value	When importers under value goods
1.Invoice price/value fixed by customs	100	150	50
2.Customs duties	5	7.50	2.5
3.VAT Base	105	157.50	52.50
4.VAT	15.75	23.62	7.87
5.Transportation, wage, interest etc.	11	11	11
6.Profit	10	7.50	12.50
7.Importer's selling price without VAT	126	126	126
8.VAT	18.90	18.90	18.90
9. Importer's VAT inclusive selling price	144.90	144.90	144.90
10. Importer's VAT liability (8-4)	3.15	-4.72	11.03
11.Income tax liability	1.5 or 3, depending upon applicable rate	1.12 or 2.25, depending upon applicable rate	1.87 or 3.75, depending upon applicable rate
12.Total tax (Customs, VAT and income tax)	25.4 or 26.9, depending upon the applicable income tax rate	27.52 or 28.65, depending upon applicable income tax rate	23.27 or 25.15, depending upon applicable income tax rate.

As indicated in the column 3 of Table 4.3, an importer may have to pay unnecessarily high taxes due to arbitrary valuation made by customs officials. Further, as excess credit under the VAT is not refunded on time, importers also suffer from cash flow problem, particularly under the existing high interest regime. The result may be opposite if values increased for customs purpose are used for the purpose of income tax also. This is because in that case importers pay 5 percent import duties on increased prices but can save up to 30 percent income tax (PIT or CIT) on it. In that case importers would gain and the government would loose. On other hand, if some importers succeed under invoicing their imports they pay low import duties and VAT, as indicated in column 4 of Table 4.3, but may have to pay high income tax.

Mongolia has adopted a Harmonized System of Classification. One would not expect the problem of mis-classification of goods when customs duties are levied with a flat rate. But during our meetings with the customs authority as well as businessmen it was reported that there is a problem of mis-classification because of valuation, which affects the tax liability. Importers try to classify high value goods as low value goods to pay less tax. On the other hand, customs officials knowingly or unknowing insist to classify low valued goods as high valued ones. One example, cited during our discussion was the engine. Engine used in automobile values higher than the engine used in textile production. Disputes arise between the importers and customs inspectors regarding the classification and values of engines.

Mongolia has also adopted an unusual system of levying customs duties in the business premises. Under this system, customs duties are not levied at the boarder point but in businessmen's premises upon his request. Such imports are recorded and sealed by the customs office, through which they enter. This office passes information about such imports and transportation to the customs offices under which jurisdiction these goods will be opened. Upon arrival of goods in the importer's business premises, the latter office inspects goods and information sent by the former customs office and levies customs duties. While the system facilitates importation but opens scope for collusion and revenue leakage.

Import duties are exempt for five years on the import of foreign investors, which is not a common practice and hard to justify.

A Customs Development Fund has been created by the order of the Minister of Finance. To this end, in addition to customs duties, fees are collected from the importers. While it was not included in the budget until 2000, from 2001 it is included in a separate budget account. Money can be spent on such areas as dress code, office equipments, office renovation etc. as per the guidelines approved by the Finance Minister, which can be tied up with the fulfillment of the annual plan by customs office.

There are two customs laws, viz; Customs Law, and Law on Customs Tariff. It is not a common practice to have two laws on customs.

Export duties levied on cashmere have been encouraging shadow economy, where the herders sale raw cashmere to the foreign businessmen at low price who, in turn, smuggle it to China.

Duties levied on raw materials and intermediate goods used for the production of exports are not refunded. As a result, there is some over spill of customs duties into exports which detracts from the competitive power of Mongolian products in the international market.

D. Prescriptions

- Under a free market, prices are likely to vary due to various reasons, including the amount of quantity bought by an importer and mode of payment such as cash or credit. So customs officials should make use of the reference prices only when

there are substantial differences (for example more than 20 percent) between the reference price and invoice price.

- Alternatively, a system under which customs administration can purchase goods by paying 10 to 15 margins and cost of goods to the importers, when it considers that goods have been grossly under valued.
- In other cases, customs administration can select importers for post clearance audit, if there are reasons to believe for an under valuation.
- When an importer goes for an appeal to the Customs Head Quarter, goods should be released on the payment of deposit as the security of the customs duties, which can be settled once the decision is made on appeal.
- Exemptions granted on the imports of foreign investors must be abolished.
- It is necessary to make exports completely free from the burden of import duties. This can be done by many different ways, including exemption of import of materials to be used in the production of exports, duty draw back system, and suspension of import duties on the import of inputs to be used in the production of exports. These options are explained in detail in Annex G to this section.
- Export duties on cashmere may be abolished and rates on some items may be lowered.
- It will be necessary to unify customs laws in order to make legal system simple and transparent.

SECTION V: PROPERTY TAXES

A. Revenue

Property taxes are not important sources of revenue in Mongolia. They currently provide about 1 percent of total tax revenue. Of the property taxes, immovable property tax is a very new tax and the revenue from this tax has been increasing. This tax provided revenue of 3225 million Tugrigs in 2002. Gun tax provided revenue of 125 million Tugrigs in 2002.

Table 5.1: Composition and Trend of Property Tax Revenue

Amount (Tugrigs in Million)	1999	2000	2001	2002	2003
Immovable property tax	182.4	150.5	1593.0	3225.1	
Gun Tax	116.9	112.4	124.0	125.3	
Total	299.3	262.9	1716.9	3350.4	4473.0
Percent					
Immovable Property tax	60.9	57.2	92.8	96.3	
Gun Tax	39.1	42.8	7.2	3.7	
Total	100.0	100.0	100.0	100.0	100.0
Property tax revenue as percent of					
Total tax revenue	0.2	0.1	0.5	0.9	1.1
Total revenue	0.1	0.1	0.4	0.7	0.8
GDP	0.2	0.3	0.3

Source: Based on data in Appendix Table A2

Like elsewhere, property based taxes are classified as local taxes in Mongolia. As the privatization of land has begun recently, base of immovable property tax will be expanded in the future and this tax may develop as an important source of revenue of local government in the days to come.

B. Immovable property tax

B1. Existing structure

Immovable property tax was introduced on January 1, 2001. This tax is levied on the immovable property, basically land and buildings. Following properties are exempt from this tax:

- Immovable property of persons, who are financed by central and local budget
- Dwellings houses
- Buildings of public use.

Immovable property tax is levied on the value of the immobile property. The base of the tax is the value registered with immovable property state registry. In the absence of such a value, value is determined by the valuation of insurance on the property. In the absence of both such values, the value that is written in accounting books will be considered as the value of immovable property for the purpose of this tax.

The annual tax rate of the tax is 0.6 percent of the value of taxable property.

B2. Issues

While the immovable property tax is supposed to be levied on both land and buildings, currently this tax is levied only on buildings since the land has not been privatized yet, the process of privatization has begun only in 2004. Of the buildings, property of budgetary organizations, dwelling houses and public buildings are exempt, meaning that the tax is levied only on business buildings. As a result, the coverage of this tax is very limited.

Exemption of private dwelling houses invites administrative complications and cause revenue leakages. This is because a building can be taxed when it is used for business purposes while it is exempt when it is used for residential purpose. Property owners simply may not report to the tax administration about the commercial use of their property. While tax administration has started surveying property and issuing certificate for each property since 2004, there may be a change in the use of property from residential to commercial and *vice versa*. In this case, it will be difficult to keep track of the use of the property. Tax inspectors also complain that property owners declare residential value, which is much lower than the commercial value, for the purpose of tax.

Further, the base fixed by the law also is not appropriate. For example, the value registered with immovable property state registry is not realistic. This is because as this value is not updated regularly, it becomes obsolete over the years due to the changing market prices and inflation. Similarly, value determined by the valuation of insurance on the property largely represents rebuilding cost, which does not necessarily correspond to the market value of the property. The book value is not an appropriate indicator of the market value either, since businesses calculate such a value on the basis of the cost of construction. Tax inspectors reported that although they find the value declared by taxpayers is too low, they cannot adjust it according to market prices since the law has not given this authority to them.

Not only the coverage of the immovable property tax is limited and base is not fixed in a realistic way, its rate is also too low.

There is a lack of detailed record of immovable property and there is no system of issuing tax bills.

B3. Prescriptions

As immovable property taxes are considered as good members of the local tax family, they have been used widely at the local level in many countries. These taxes satisfy the principles of autonomy of local taxation, which advocates that the local governments are given some autonomy to fix tax rates or bases according to local conditions. Under this situation, there may be a variation in tax rates among local governments. Variations in the rates or bases of immovable property taxes are likely to cause fewer distortions in the economy than would similar variations in income and commodity taxes, i.e. resources are not likely to be diverted due to differentiation in immovable property tax rates due to the immovable nature of house and land unless the base and rate differentiation are very large among local governments.

Immovable property taxes also provide a high degree of accountability due to their visibility to the taxpayers. This is because since electorates are aware of the tax liability, they keep interest in the income and expenditure of the local governments and complain about any mismanagement of the public fund. It makes local governments accountable to the local people.

The base of immovable property tax is localized. Immovable property is most easily controlled by the local authorities. Immovable property taxes levied on local residents cannot

be exported, either. Since revenue generated from these taxes is used in the activities benefiting local people, it enhances compliance also.

It is, therefore, necessary to develop immovable property tax as the major source of local revenue.

Immovable property tax should be continued to be levied on each piece of immovable property. It should be levied as tax on objects, not as a tax on persons. If it is to be levied as a tax on person, it will be levied on all immovable property of a person, which may be scattered in different parts of Mongolia. As currently local taxes are administered by the central tax administration, it will be feasible to levy such a tax now. But when local governments will be made responsible to manage their taxes locally, a tax levied on person will be difficult to administer by the local tax administration. Such a tax will not be justified at the local level any way. So existing system of levying immovable property tax on each piece of land should be continued.

Immovable property tax should be extended to residential houses also. Similarly, once land is privatized, the tax should be levied on both residential and commercial land. It also should be levied on undeveloped land, if any, owned by private individuals or businesses.

A valuation unit may be created for valuation required for the purpose of whole public sector. As Mongolia is not a huge country, there is no need to have several valuation units under different organizations. Since the tax administration will be making maximum use of the value of real property when the immovable property tax is levied on both land and property, the valuation unit may be kept within the tax administration. This office could collect market value from time to time and put in the data base.

Rate should be flat as it is now. This is because progressive rate structure not only complicates tax administration but also encourages property owners to divide their property artificially, thereby generating both inefficiency and inequity in the tax system. It is, however, necessary to increase the rate to 1.2 percent. From an autonomy point of view, it will be necessary in the future when local government would be in a position to levy this tax to fix maximum and minimum rates of the immovable property tax and allow local governments to fix rates within these limits as per their requirements.

It is necessary to prepare a detailed inventory of all properties for an effective implementation of immovable property taxes. For this, it is necessary to prepare property maps, where all properties are recorded in a manner that cannot be eradicated and each property is given a number. Such a numbering system is necessary to post tax bills and implement property tax effectively. Records must be updated periodically. Maintenance of such a detailed records on the type, size, location, extent of improvements, ownership etc. of every property will be the basis for ensuring that every property owner settles his dues properly.

It would also be useful to issue tax invoices every year in the name of taxpayers. Until now, there is no system of issuing tax bills. Tax administration rather relies on taxpayers to come voluntarily to pay their tax liabilities. In the future, tax administration should issue tax bills and send them to the taxpayers asking to pay the tax within specified date. It is necessary to decide such issues as: How many times bills should be raised in a year? Under whose name bills should be issued in the case of houses and compounds possessed by a spouse or minors? What should be the process of delivering tax bills? What should be done if bills are not delivered? And so on.

C. Gun tax

Gun tax is levied on all kinds of guns save the guns which are used by personnel's arms in state defense, state security, policy and prison at the following rates:

Table 5.2: Rate Structure of Gun Tax

Kinds of guns	Annual rates (in Tugrigs)
Pellet rifles	4,000
All kinds of guns up to 6.4 mm. caliber	4,000
All kinds of guns of 6.5 mm. caliber	6,000

Gun tax provided total revenue of 125 million Tugrigs in 2002. Revenue from this tax goes to the local budget.

SECTION VI: SOCIAL SECURITY CONTRIBUTIONS

A. Revenue

Social security contributions are significant sources of tax revenue. They generate about 16 percent of total tax revenue. As indicated in Table 6.1, they generated revenue of 63,623 million Tugrigns in 2003.

Table 6.1: Composition and Trend of Social Security Contributions

Amount (Tugrigns in Million)	1999	2000	2001	2002	2003
Social insurance	23,398.7	30,059.4	41,427.7	41,882.6	0
health insurance	6,386.2	9,213.3	12,528.9	12,515.0	0
Total contribution	29,784.9	39,272.7	53,956.7	54,397.6	63,623.2
Percent					
Social insurance	78.6	76.5	76.8	77.0	0.0
Health insurance	21.4	23.5	23.2	23.0	0.0
Total contributions	100.0	100.0	100.0	100.0	100.0
Social security contribution revenue as percent of					
Total tax revenue	16.4	15.1	16.4	15.1	15.7
Total revenue	12.0	11.3	12.5	11.6	12.1
GDP	3.2	3.9	4.8	4.4	4.7

Source: Based on data in Appendix Table A2.

Social security contributions are broadly divided into two groups, viz; social insurance and health insurance. The former constitutes roughly three fourth while the latter roughly one fourth of total contributions.

B. Existing system

Mongolia implements an extensive system of social security contributions. It covers benefits relating to retirement, loss of the ability to work, sickness, unemployment and death.

Social insurance can be either compulsory or voluntary. Employers and government servants are subject to compulsory insurance while citizens engaged in any production or services can decide themselves whether to register with social insurance and which types of insurance to choose. Military, police, intelligence personnel, and fire fighters are not required to contribute. Foreigners and entities residing in Mongolia and employed by any Mongolian organization, and citizens of Mongolia employed by foreign organizations or business entities carrying out their activities in Mongolia will have to register with the social insurance legislation.

Social insurance premiums for employers and employees (insures) are fixed at the following rates:

Table 6.2: Rate Structure of Social Insurance Premiums

Insurance type	Premium amount (as a percentage)	
	employer's payroll and similar revenue	insured's salary and similar income
Pension insurance	13.5	5.5
Benefit insurance	1.0	1.0
Industrial accident and Occupational disease insurance	1.0, 2.0 or 3.0	-
Unemployment insurance	0.5	0.5
Health insurance	3.0	3.0
Total	19.0, 20.0 or 21.0	10.0

While both employers and employees are responsible for paying the premium of pension, benefit, unemployment and health insurances, employers are required to pay in the full amount for industrial accident and occupational disease insurance on behalf of employees. Employees will have to pay 10 percent up to a gross monthly salary of 400,000 Tugrigs. An employee's total contribution will be 40,000 Tugrigs if his gross monthly salary exceeds 400,000 Tugrigs. Children under 16 years are covered for health insurance under their parents.

The minimum amount of social insurance premium to be paid monthly by voluntary contributors shall be not less than amount calculated in relation to the minimum salary level fixed by the Government. The minimum monthly salary is 40,000 Tugrigs and the maximum monthly salary is 400,000 Tugrigs. Rate structure of the social insurance premium for voluntary contributors is as follows:

Pension insurance: 9.5%

Benefit insurance: 1.0%

Industrial accident and
Occupation disease insurance 1.0%

Voluntary contributors can choose any one, two or all of the above insurances.

Premiums are calculated according to the premium report or the employer's payroll and similar revenue, the employees' wages and similar income, and premium identifying sheet.

Social insurance premiums are paid on a monthly basis. Employers are required to retain social insurance premium due to be paid by employees from their wages and other similar income at each pay, and have to transfer it to the central bank account of the insurance authority in the same month.

The monthly premiums to be paid by employees and employers will have to be paid by the 5th of the following month.

Employers registered with the central and local tax administrations in accordance with law and paying premiums will be supplied with a social insurance certificate with a state number.

Employees are provided with a social insurance booklet and a health insurance booklet with a state registration number. Social security contributions and health contributions from both employers and employees are recorded in these booklets separately.

Citizens who have registered for social insurance and who have paid insurance premiums are entitled to receive the pensions and benefits. Non-payment of social insurance premiums as a result of fault of the employer will not preclude an employee or members of his or her family from pensions and benefits.

Operation of Social Insurance

Social insurances are operated under different funds. There are five social insurance funds, one for each type of social insurance.

- pension insurance fund;
- benefit insurance fund;
- health insurance fund;
- industrial accident and occupational disease insurance fund;
- unemployment insurance fund.

Social insurance fund's incomes come from the following sources:

- social insurance premiums paid by insures;
- social insurance premiums paid by employers;
- bank interest on deposits of the uncommitted balance;
- penalties imposed for delay in paying social insurance premiums;
- contributions from the state central budget;
- other sources.

The social insurance fund's expenses are made in the following areas:

- paying pensions and benefits;
- financing the cost of social insurance activity;
- financing other payments and costs as per the law.

It is prohibited to transfer money from one type of social insurance fund to another or to spend them or use or deposit them improperly.

C. Issues

The Mongolian social security contribution system is a flat system. Rates are flat for all sort of income, there is no minimum threshold, and rate is 10 percent on employees up to 400,000

Tugrign gross monthly salary. There is, however, upper limit i.e., employees having gross monthly salary over 400,000 Tugrign will have to contribute 40,000 per month.

While an employee who has worked for at least 10 years, can get some sort of pension (interest equivalent pension) but it is necessary to work at least 20 years in order to get full pension. The pensionable age for men is 60 year and over and for women 55 year and over. A full amount of pension will be paid who were born prior to January 1, 1960. (An employee who was born on and after the January 1, 1960 will have the individual contribution account for pension insurance). Pension is calculated at the rate of 45 percent of the average monthly salary having worked for at least for 20 years. 1.5 percent of the salary will be added in the case of those employees who have paid social security contribution for more than 20 years. Further, the pension will be increased by 1 percent each year in the case of insured elderly age people who have received pension disability. The minimum size of pension for elderly people will be minimum 75 percent of the lowest rate of salary.

Pension does not depend upon the amount of social security contribution. Rather, pension is determined on the basis of 5 consecutive year's salary. It is the employee who can choose which 5 years, in the beginning, in the mid or at the end of his employment period. As pension does not depend upon the amount of social security contribution paid, particularly young employees do not want to pay now.

The social security contribution system is regressive in the sense that only those who participate in the social security contribution get social benefits, including health benefits. Those people who are not working or not participating voluntarily due to the lack of income are deprived of these benefits.

Social security funds are run as state organizations which cannot investment their fund on bond or can not open their accounts in commercial banks where they can get high interest.

D. Prescriptions

There are different views regarding social security contribution. One view is that social security is a public good, so it is one of the important responsibilities of a modern government. It should be an expenditure item in the budget and financed by general government revenues, if revenue is not adequate, it is financed through deficit financing also. That is why in some countries there is no system of social security contributions. On the other extreme, social security is considered as a semi-social insurance premium. In USA and many other developed countries social security benefits are financed through social security contributions. Social security contributions are earmarked, they provide right to benefit. Such a system encourages taxpayers to pay these contributions.

Mongolia follows the second line. However, premiums of social contribution are rather high. It should be seen in the context of high PIT rates. This indicates the need of lowering the premiums of social security contributions significantly. One option could be the abolition of all social security contributions other than pension insurance and finance them through the general budget revenue. Pension fund also can be run as an investment fund. An in-depth study may be carried out on the pension reform and the possibility of abolishing all other contributions and financing social benefits through the general budget.

SECTION VII: LOCAL TAXES

A. Status

Like in any other countries, local governments are responsible for providing various local services to the local people in Mongolia. It will not be feasible to provide public services by these bodies in the absence of adequate financial resources. Local governments need their own revenue in order to carry out projects according to the needs of their constituents. Revenue is commonly generated through local taxes, which also improve voluntary compliance of the taxpayers, who see the immediate benefits to be received from their tax money paid to the local government than the taxes paid to the central government. Further, local taxes can also be justified in a large mountainous country like Mongolia where it will be difficult for the national government to reach to the local level effectively.

Local level taxes are specified in the General Taxation Law and given in Annex A of this report. According to this Law the rates of (a) fees for use of hunting resources, animal hunting and catching license fee, (b) land fees, and (c) fees for cutting and use of wood fuel and timber from forest shall be fixed by the government within the limits approved by the Parliament. Rates of other taxes shall be fixed by the Aimag and Capital City Hural of Citizen's Representatives, within the minimum and maximum rates given in the tax acts.

Budget law specifies the revenue to be deposited to the local budget. As per this law, revenue is allocated among various governments as follows:

Central budget revenue:

1. VAT
2. Customs tax
3. Excise tax
4. Income tax
5. Gasoline and diesel fuel tax
6. Fee for use of mineral resource

Local budget revenue

(a) Aimag/City budget revenue

1. City tax
2. Fee for use of mineral resource
3. Land fee
4. Payment for use of water and springs
5. Licensing fee for mineral exploitation and usage
6. Immovable property tax

(b) Soum/District budget revenue

1. Tax on auto and self-moving vehicles
2. Inheritance and gift tax
3. Gun tax
4. Dog tax
5. State stamp duty
6. Payment for use of hunting resources, licensing fee for animal hunting and catching
7. License fee for use of natural resources other than minerals
8. Payment for use of natural plants
9. Fees for use of wood fuel and timber from forest
10. Fees for use of widely spread mineral resources
11. Payment for use of water and springs

There is also a revenue sharing. For example, certain percent of VAT collection is granted to the local bodies on the basis of certain formula. Similarly, PIT revenue generated from business income also goes to the local budget.

B. Issues

While several taxes have been specified as local taxes not all of them are being implemented. For example, no law has been enacted yet in the case of capital city tax, dog tax, and inheritance and gift tax, meaning that these taxes are not implemented yet.

Further, assignment of some of the taxes to the local level does not seem appropriate. For example, taxes levied on persons, such as income taxes and inheritance and gift tax are not good members of the local tax family. In addition to revenue generation, these taxes are also levied to achieve some broader social objectives, which cannot be implemented effectively at the local level. This fact was realized in Mongolia in 2002, when the personal income tax was converted from local tax to a national tax. But inheritance and gift tax is still a local tax.

Furthermore, the allocation of natural resource based taxes to the local governments also does not seem appropriate. While natural resources are not equally distributed, Mongolian of different areas should have right to use these resources in an equal manner. This means that natural resource taxes should be levied at the central level and revenue should be distributed to all local bodies.

While as per the law, rates of some taxes could be fixed by the central government and others by the local legislator within the limit fixed by the national parliament, in practice, in case of most of the taxes, instead of minimum and maximum rates, just one rate is given in the tax laws. In such cases, local bodies do not have any scope to adjust rates according to local conditions. It was told that local bodies have not been authorized to adjust rates, even in the case where in the law minimum and maximum rates are given. These rates are controlled centrally. Thus, currently tax base, rates etc, are fixed by the centre and also the revenue is collected by the central government's tax offices. However, revenue collected from the so called "local taxes" goes directly to the local budget.

While there is transparency in terms of revenue allocation the system lacks autonomy and accountability. This is because local governments cannot fix tax rates, base etc. as per the local conditions and requirements. Further, as local governments are not involved in the revenue collection, there is a lack of accountability on their part. This means that the existing system of local taxation does not meet the principles of autonomy and accountability of the local taxation.

C. Prescriptions

There is a need to gradually develop a sound local fiscal system in Mongolia. There are many countries in the world which are less developed than Mongolia but are implementing taxes at the local level. Mongolia also should initiate the process slowly. For example, local governments should be allowed to fix rates within the limit fixed by the parliament and bases of some taxes and use revenue locally as per the local requirements. In the beginning tax offices of the central government could assist the local governments in assessing and collecting their tax revenue. Management of local taxes by local governments would promote autonomy and reduce administrative and compliance costs.

Tax sharing mechanism also can promote autonomy at the local level. This is not new for Mongolia. For example, while VAT is administered entirely by the tax administration of the central government, certain percent of the tax collected through VAT is distributed to local governments. Similarly, PIT revenue collected from the business incomes is deposited to the local budget. Revenue sharing mechanism also could be introduced in the case of natural resources based taxes. Tax sharing system minimizes administrative and complicate costs. There is no distortion due to the uniform tax system among the local governments. It also provides access to the local government to the broad based centrally reserved taxes.

In theory, local governments could also be authorized to levy piggybacking (surcharge) on the central government tax base or tax amount. This would reduce both administrative and compliance costs and would provide substantial revenue since it would be levied on broad base reserved for the central government, and at the same time would provide some autonomy to the local government to fix tax rates. However, as revenue from the broad based such taxes as VAT and PIT is shared between the national and local governments, there is not much further scope for piggybacking in Mongolia

Once local government's capability increases substantially, they should be allowed to levy and collect some taxes independently. Actually central government laws have already specified some taxes as local taxes. It is a matter of implementation. Local governments then should be given full autonomy relating to policy, administration and revenue within the range specified by the central government law. This would provide autonomy to the local governments and makes them accountable to the local people.

For all this to happen in a systematic manner, a long term strategy needs to be developed regarding central-local fiscal relations. The ultimate goal should be to develop a good local tax system that meets all important criteria of a good local tax system. For example, local government should have adequate fiscal autonomy to raise revenue to respond to the needs and preferences of the local people. While local governments cannot go against the tax policy of the central government, they should be given authority to adjust local taxes according to the local conditions.

A local tax system should promote the accountability of local government. A direct tax system promotes accountability since the burden of such a tax is seen by the local people so that they will always keep an eye on the local budget and complain about any mismanagement of public funds.

Another criterion of a good local tax is the localization of tax base. This means that the tax base should be local and the burden of the local taxes should not be exported to outside the local area.

Taxes levied on immovable property meet all above-mentioned criteria. That is why these taxes are considered good local taxes in theory and also being implemented as the major sources of local government revenue in many countries around the world. While Mongolia does levy an immovable property tax, the current tax base is too narrow since the tax is levied only on the commercial buildings. Further, in practice land is also outside the tax net, since it is not yet privatized. It will, therefore, be necessary to speed up the process of privatization of land. In the mean time local governments can levy other taxes and strengthen their tax administration. Once land is privatized, then they could levy a broad based property tax, which should be the important revenue raisers of the local governments but supplemented by a few other taxes.

SECTION VIII: NON-TAX SOURCES

A. Background

Government of Mongolia raises revenue from non-tax sources also. Non-tax revenue includes dividend, income earned by budgetary organizations, interest, rent, oil income, navigations income and central Bank's profit. While the line of distinction between tax and non-tax revenues is often thin, some revenue sources such as royalty, forest income, license fee for use of natural resources, except mining resources, payment for use of natural plants, payment for use of water and springs, payment for use of widely spread mineral resources which are classified as taxes in Mongolia are commonly defined as non-tax sources around the world.

As the main objective of non-tax sources is other than revenue, they are generally not considered effective instruments of revenue generation. However, in the case Mongolia, rental income from natural resources is potentially important sources of government revenue.

B. Revenue

As indicated in Table 8.1, non-tax revenue was 121,958 million Tugrigns in 2003, of which 65,990 million Tugrigns was generated through budgetary organizations. Other important sources are navigation income, income from rent and income from interest and fines. Central bank's profit also has emerged as an important source of non-tax revenue in the recent years.

Table 8.1: Composition and Trend of Non-Tax Revenue

Sources	1999	2000	2001	2002	2003
Amount (in Million Tugrigns)					
Dividend	5,690.4	17,189.8	19,865.7	6,402.6	1,938.3
income earned by budgetary organs	32,070	35,184.5	47,169.6	47,953.6	65,989.9
interest and fine	3,510.4	8,135.0	7,984.4	9,062.0	17,035.9
income from rent	6,401.7	6,309.6	8,438.3	9,364.9	10,232.5
oil income	500	500.0	450.9	599.3	0
navigation income	10,000	9,611.5	10,389.8	12,500	12,113.7
Central Bank's profit	0	0	1,500	8,954.2	8,427.9
Other income	8,454.3	8,634.1	5,949.3	15,732.9	6,219.8
Total	66,626.8	85,564.5	101,748.2	110,569.4	121,958.0
Percent of total					
Dividend	8.5	20.1	19.5	5.8	1.6
income earned by budgetary organs	48.1	41.1	46.4	43.4	54.1
interest and fine	5.3	9.5	7.8	8.2	14.0
income from rent	9.6	7.4	8.3	8.5	8.4
oil income	0.7	0.6	0.4	0.5	0.0
navigation income	15.0	11.2	10.2	11.3	9.9
Central Bank's profit	0.0	0.0	1.5	8.1	6.9
Other income	12.7	10.1	5.8	14.2	5.1
Total	100.0	100.0	100.0	100.0	100.0
Non-tax revenue as percent of					
Total revenue	26.9	24.7	23.7	23.5	23.2
GDP	7.2	8.4	9.1	8.9	8.9

Source: Based on data in Appendix Table A2

Non-tax revenue constitutes about one-fourth of the total revenue. Non-tax revenue is about nine percent of GDP.

C. Problems and Prospects

C1. Rental Income from Natural Resources

Mongolia is rich in natural resources. Particularly, mining is important sector of the Mongolian economy that contributes about 10 percent of GDP (see Annex H). This sector should provide correspondingly significant part of revenue to the national treasury. Mining sector should contribute more to the government fund from other angles also. Mining causes environmental damage. For example, as a result of mining water level goes down. It affects forestation, agriculture and aggravates the problem of drinking water. All these will escalate the volume of public expenditure in the days to come. Mining sector must bear these costs; it should not be subsidized by other sectors.

Mining sector currently pays revenue in different ways such as exploration license fees, mining license fees, royalties, income taxes and VAT. Current rates of mining exploration license fees, mining license fees and royalties are as follows:

Annual fees payable per hectare for an exploration license

First year	\$0.05
Second and third year	\$0.10
Fourth and fifth year	\$1.00
Sixth and seventh year	\$1.50

Annual fees payable per hectare for a mining license

First three years	\$5.00
Fourth and fifth year	\$7.50
Sixth year onwards	\$10.00

Royalty rate is 2.5 percent on the sales value of all products except gold extracted from the mining claim that are sold, shipped for sale or used. The corresponding figure for the gold is 7.5 percent.

It is necessary to increase royalty rates, particularly mining, in order to compensate loss in revenue due to reduction in the income tax rates. As William F. Arnold states "Higher royalties coupled with lower taxation rates could have a neutral impact on the mining companies (in terms of the "Effective Overall Taxation Rate") while improving the government's short term revenues."

Natural resources are not equally distributed to different region. But all Mongolians should get equal share of these resources. For this reason, revenue from this sector should go to the national coffers; mining related tax/non-tax sources should be central, not local. A concept of revenue sharing between the central and the local governments may be justified to some extent. Another alternative could be the creation of the "Mongolia Children Fund" and deposit all revenue from the rent generated from natural resources to this fund. In this way, children from all over Mongolia would benefit from natural resource income.

C2. User charges

Government provides such public services as water, sewerage, heating, electricity etc., which are generally not so attractive for the private sector. There has been a growing emphasis on the

finance of these services through user charges. User charges are justified on both the efficiency and equity grounds. Since the imposition of user charges reduces the wasteful use of public services, it promotes efficiency. Further, imposition of the user charges on the basis of the use of government services is also justified from an equity point of view. Besides, user charges can be used to influence private behavior toward socially desirable ends.

However, in Mongolia user charges have not been fixed in an economically efficient way. Price of some public service does not depend upon their actual consumption. For example, as indicated Table 8.2; heating fees are based not on the use of heating but on the basis of the size of the houses / buildings. Similarly, rates for water use are levied on per capita basis. It will be necessary to charge service fees on the basis of their consumption, and rates should be fixed at least to cover the cost of services.

Table 8.2: Annual Fees for Public Services

(Amount in Tugrigs)

Public services	1999	2000	2001	2002	2003	2004
Housing space fees, m2	80	80	80	80	80	
Heating fees, m2	74	82	184	184	184	184
Monthly water use fees, per capita	582	744	1086	1478	1478	1478
Electricity, 1 KW	40	40	52	53	54.05	54.05
Bus fare	121	200	200	200	200	
Air ticket fare, 500 km	22,550	26,250	29,550	29,642	30,100	
Domestic postal charges	250	250	238?	280	400	
UB-Dornod tel. call, 3 minutes	695	695	707	707	707	

C3. Regulatory/service fees

Government also generates some revenue from some regulatory fees. It is necessary to take approval of the government to set up industries, business or profession and so on. Similarly, it is necessary to register vehicles, guns etc. Government can charge some fees to recover administrative costs relating to these services or it may even levy such fees as regulatory fees on revenue earners. Government also provides such services as notarial and consular and charges fees for them. These regulatory or service fees are collected in the form of stamp duties. These duties are also levied for the issue or registration of documents, which authorise or transfer rights, for the certification of contracts and documents, for the registration of the status of citizens and for the settlement of legal disputes by the Courts. Stamp duties are levied on the following services:

- The settlement of legal disputes by the Courts;
- Notarial services;
- The registration of the status of citizens and the issue of passports, permits and visas;
- Consular services;
- The registration of vehicles and the issue of permits to drive;
- The registration of guns;
- The registration of newspapers and magazines;
- The registration of business entities and organisations;
- The granting of authorisation to establish business entities with foreign investment and representative offices of foreign organisations;
- The granting of authorisation to provide services which require, or to carry out production which requires, special authorisation or expertise;
- The issue of patents for inventions and industrial designs, the registration of trade marks, ensuring the validity of patents and the registration of licences in respect of patents and trade marks;

- The registration of copyright works;
- The granting of permission to carry out activities in respect of securities and the registration of securities; and
- Any other services provided by the Stamp duties law.

Most of the fees are very low. For example, duty for the registration of immovable property is 0.01 percent of the value of the property. Such a rate is generally fixed between 1 to 2 percent in many countries. A few examples of other rates are given below:

Table 8.3: Regularity/Service Fees

Activities/Services	Rates in Tugrigs
• certification of non-property agreements and contracts or agreements and contracts	500
• certification of property lease agreements	750
• certification of documents of the creation of legal entities	2,000
• registration of birth and the issue of a birth certificate	100
• registration of marriage and the issue of a marriage certificate	125
• recording a divorce (for each party)	250
• issue of a passport to a citizen	1,500
• extension of the term of a passport	75
• issue of a certificate of vehicle ownership	250
• issue of a permit to drive	750
• issue of a registration number for a car	1,000
• issues of a gun registration certificate for citizen (for foreigners US\$10.00 or the equivalent in Tugrigs).	250
• registration of copyright works	250
• Similarly, duties are levied at the following rates for the registration of the business entities etc. and issue of a registration certificate	
(a) a company	10,000
(b) a co-operative company	6,000

Activities/Services	Rates in Tugrigs
(c) a sole proprietorship	5,000
(d) a bank or insurance organisation	20,000
<ul style="list-style-type: none"> For amendments to the register for a business entity or organisation 	1,000
<ul style="list-style-type: none"> For the registration of a political party or public organisation 	1,000
<ul style="list-style-type: none"> For the issue of a permit to establish and operate a foreign branch or representative office 	US\$500 (or the equivalent in Tugrigs)
<ul style="list-style-type: none"> For an extension of the term of a permit to operate a foreign branch or representative office - 	US\$200.00 (or the equivalent in Tugrigs)
<ul style="list-style-type: none"> For the issue of a permit to establish a business entity with foreign investment 	6,000
<ul style="list-style-type: none"> For an extension of a permit to establish a business entity with foreign investment 	3,000

As most of the above-mentioned rates are too low, they need to be raised substantially.

While organisations authorised to collect stamp duties under the stamp duties law will have to collect duties either in the form of cash or through bank accounts, tax office will be responsible for overall monitoring of these fees.

SECTION IX: APPEAL SYSTEM

A. Status

It is necessary to establish and develop an impartial and effective appeal system in order to create an environment where taxpayers can complain when tax is not levied upon them according to the law. Such a system not only protects taxpayers right but also creates their belief in the tax system. An appeal system also ensures proper implementation of tax laws. That is why there is a common practice around the world to set up an appeal mechanism where taxpayers can complain when they are not satisfied with the tax officers' decisions and Mongolia is not an exception to it.

A1. Structure of administrative review/appeal

A1.1 Tax administration

There is a provision to solve taxpayers' complaints through the administrative procedures within the tax administration at two levels as follows:

- Complaints about a tax inspector's decision shall be solved by the tax administration where a tax inspector works or to which he/she directly belongs.
- Complaints about decisions of tax administration shall be solved by the tax administration at a higher level.

A1.2 Tax dispute settlement council

There is also a system of the Tax Dispute Settlement Council (TDSC). TDSCs are created at two levels as follows:

- Aimag and Capital City Tax Offices
- The General Department of National Taxation

TDSCs, both at Tax Offices and at the General Department of National Taxation (GDNT) level, should have at least five members, including chairman and secretary. Members of the Council should have a background of finance, tax, economics or law. Representative of taxpayers also can be appointed as members of the TDSC. Currently, the President of the Taxpayers Union is one of the members of GDNT level TDSC. There is no fixed term but in practice they are generally appointed for two to three years. The Head of Department of the Policy and Budget of the Ministry of Finance becomes the Chairman of the GDNT level TDSC while the Head of Planning, Finance and Economic Policy Department of the Governor's office heads the TDSC at the Aimag or Capital City Tax Office level.

Members of the GDNT level TDSC are appointed by the Minister of Finance while the members of Aimag or Capital City Tax office level TDSC are appointed by the Governor of the Aimag or Capital City.

A1.3 Court

Judicial system is divided into three levels as follows:

- Soum and District Court
- Capital City and Aimag Court
- Supreme Court

Soum or District Courts hear civil and criminal cases which are considered minor cases. Capital City or Aimag Courts have three different benches viz., Civil, Criminal and Administrative. The Administrative case bench of the Capital City or Aimag Court, which hears administrative cases, is also responsible for tax disputes. (As there was no provision for an administrative bench in the court until May 2004, tax cases used to be handled by the civil case bench.) Similar system exists at the Supreme Court.

A2. Appeal process

If a taxpayer is not satisfied with tax assessment or imposition of penalty or both by a tax officer, then the former can file a complain with a tax office level TDSC within 14 days of the notification of taxes. Secretary processes cases and together with his opinion distributes to the other members. Decision on appeal should be given within 30 days. But in case of time consuming cases, Chairman of the TDSC may extend another 30 days only once.

If taxpayer is not satisfied with the decision of tax office level TDSC, he or she can appeal either to upper GDNT level TDSC within 14 days or to the district court within 30 days. This also applies when a tax officer does not agree with the decision of tax office level TDSC. TDSC located in the GDNT should give its decision within 14 days. If decision is not given within this time, the case can be taken to the court. As for the Administrative cases court, period of time to render decision varies from location of the Court. In the Capital city, decision should be rendered within 30 days but in Aimag within 40 days. The Supreme Court is located in Capital City. In some instances, decision period can be extended 30 days once and 15 days twice.

A3. Fees

When a taxpayer goes for an appeal to the court he has to pay stamp duties, which depends upon the disputed amount as follows:

Table 9.1: Stamp Fees

Amount of Claim (in Tugrigs)	Duty (in Tugrigs)
Up to 3000	50
3001-10.000	2 percent of the total amount of claim
10.001-50.000	200 plus 3.5% of the amount of the claim that exceeds 10.000
50.001-500.000	1500 plus 4% of the amount of claim that exceeds 50.000
500.001-1.000.000	19.500 plus 2.1% of the amount of claim that exceeds 500.000
1.000.001-10.000.000	30.000 plus 1.4% of the amount of claim that exceeds 1.000.000
More than 10.000.001	156.000 plus 0.5% of the amount of claim that exceeds 10.000.000

B. Issues

The existing appeal system is governed by various laws as follows:

- General Taxation Law of Mongolia 1992: TDSCs have been created under this law, but not detail provisions are made regarding TDSCs.
- Cabinet Regulation on activities of the TDSC/Procedure of Tax Dispute Settlement Council, Number 189 of 17 November 1999: Provisions relating to the compositions of TDSC, their qualifications and appointment of members, period within decision must be made by the TDSC etc. are included in the Cabinet Regulation on activities of the TDSC/Procedure of TDSC.

- The Law on Imposing Tax, Supervising Tax Payment and Tax Collection, 2002: This Law has opened the scope for administrative review but no procedures have been specified for it.
- Law on Solving Complaints to the State Officials from Citizens: This law deals with procedures receiving and scrutinizing the complaints and requests.
- Procedure to Handle Complaints from Citizens to the All Level of Tax Offices /approved by the Head of General Department of National Taxation, # 69 of 10 June 1996/. This law provides procedures to receive and scrutinize complaints and requests.
- Law on Administrative Procedure: This law is related to the fine for the breach of tax laws.
- The Law on Stamp Duties of Mongolia: This law deals with the fees relating to appeals.

As appeal system is governed by many laws, it is difficult to understand the appeal system. On the other hand, not all aspects of appeal have been sufficiently covered even in all these laws. Further, the design of appeal system itself seems to be faulty. While there is a provision for some sort of administrative review, there is a lack of detailed provision regarding administrative review. On the other hand, there are TDSCs both at the tax office and at the GDNT level. Parallel provision for administrative review and the TDSC system almost in the same organization does not make any sense. It is simply a duplication of work. Further, TDSC does not seem to be a professional body. TDSC members are ex-officio members rather than fulltime members and they may not be able to provide sufficient time. Further, members of TDSC do not have a fixed term. Furthermore, the chairmen of both tax office level TDSC and GDNT level TDSC are ex-officio. This also means that Chairman of TDSC will be changed once there is a change in the Head of Department of the Policy on Budget of the Ministry of Finance and also the Head of Planning, Finance, and Economic Policy Department of the Governor's office.

As decisions on appeal are not published, others do not know about such decisions and there are possibilities of different decisions being made in similar cases.

C. Prescriptions

The above discussion indicates a need for the reform of appeal system. It is necessary to draft a separate appeal law and include all appeal related provisions in one law. It will also be necessary to consider the following aspects which are not covered under any existing law relating to appeals at the time of designing the new law.

C1. Scope of appeal

First of all it will be necessary to define the scope of appeal, meaning that which decisions made by the tax administration can be appealed. Basically decisions relating to tax assessment and penalty can be appealed. But there is also an increasing trend to include other decisions as that can be appealed decisions since they ultimately may have implication on tax liability of a taxpayer. These decisions may include decision regarding registration, cancellation of registration, accounting, invoicing, input tax credit, deductible expenses, interest, tax return, market price, tax assessment, suspension of the transactions, property ban and so on.

C2. Administrative review

Many countries have a system of administrative review, where taxpayer if not satisfied with the decision of a tax officer, can appeal first to the higher tax authority. Such a system is beneficial for both tax administration and taxpayers. All tax offices may not have employees with adequate knowledge of tax. As a result, the tax officer may have made some decisions without following the tax law. Similarly, the principles of accounting or tax may not have

been followed while assessing the tax. In this situation, the provision of Administrative Appeal provides an opportunity to correct minor errors of tax administrators internally. Similarly, since the Administrative Appeal has to be done in a short period, taxpayers will benefit from such a system.

Some times it is argued that since the high level tax officials may be biased, or may not be able to give a ruling against the decision of a colleague employee, or may not change the decision of the employee if there is a possibility of a revenue loss and may not be able to give sufficient time resulting in delay in decision-making the system of administrative review does not work well.

In this respect, the system of dispute settlement council may work better. Such a committee can be more impartial and effective and also can decide cases quickly since it is constituted exclusively to settle disputes. But its members should be expert in the related areas and also full time officials.

Detailed provisions should be made regarding administrative review, which can be designed either exclusively within the tax administration or in line with the existing TDSC system but with some permanent manner.

C3. Payment/deposit of disputed tax amount

It will be also necessary to give a thought on the payment/deposit of the disputed tax amount. There are various perspectives on whether disputed tax needs to be paid or not while appealing. One line of thinking is that disputed amount should not be paid since it will create economic difficulties for those who are unable to pay and create a situation where taxpayers are unable to appeal, resulting in deprivation of their right to appeal. The system of depositing may not be justified due also to the following factors:

- High interest rates in Mongolia,
- Due to the high amounts of deposit coupled with high interest might increase in the practice of collaborating with the tax administrator to resolve the case,
- Taxpayers will be penalized if decisions are not made on times. Even if the case is won by a taxpayer, it will not be certain whether the paid/deposited amount will be returned in the absence of a properly working refund system.

The other line of thinking might insist on the payment/deposit of the disputed amount in order to go to an appeal. According to this view, although the decision of the tax officer may not have caused much harm to the taxpayer, there is a possibility that the taxpayer will appeal just for the sake of delaying the time of the tax to be paid if payment/guarantee is not there particularly, considering the high interest rates in Mongolia. This will result in increased unnecessary workload of the hearing body, delay in giving decision, create more difficulties for those taxpayer who have been affected by the decision of the tax officer and gone for an appeal.

There is also a belief that deposit of the debated amount should not be made mandatory. It should be governed by an appropriate rate of interest. If a taxpayer has deposited the amount and if he wins the case, the amount should be returned easily with interest and, if the taxpayer loses the case, the tax amount and interest must be collected if the taxpayer has not deposited a guarantee.

C4. Suspension of activities

In the appeal law, it will also be necessary to mention that the taxpayer's responsibility to pay tax, interest and penalty gets suspended after a petition is filed.

C5. Decisions to be made public

Decisions on an appeal should be made public, which will generate information to tax administrators, tax professionals and taxpayers and such mistakes will not occur again in future.

C6. Expenditure related to appeals

There are various perspectives on who should bear the costs related to taxpayer's appeals. According to one belief, if the taxpayer wins the case, full or partial expenditure should be borne by the tax administration. Tax administrators will be more cautious while making decisions if the administration has to bear the expenditure related to the taxpayers' appeal. If the tax administration has to bear the expenses related to taxpayers appeal and if the situation is such that the taxpayers win the case repeatedly, it will lower the budget of the administration and impact other works. This will also cause the tax administrators to be more cautious while making decisions. As per the existing provision, party at fault should pay the following costs of the court:

- Transportation, accommodation and meal cost of the expert, interpreter or translator, as well as payment due for the work done not related to the duty under the court ruling.
- Salary or payment, meal, accommodation, and transportation cost of witness
- Expenditure related with survey, experiment and identification measures
- Keeping cost of proof
- Transportation cost spent in order to conduct interview with witness

C7. Fee related to appeals

Certain fees may be imposed to appeal in order to avoid cases of appeal of unnecessary and small amounts. The system of paying a certain fee to appeal will discourage taxpayers from appealing for small amounts nearly equivalent to the fee. In some countries, appeal cannot be made of cases up to certain fixed amount. In Mongolia, fees charged for appeal (up to 4 percent) seem to be rather high. Some taxpayers may be prevented from their right of appeal due to high fees. So fees should be fixed at a low level.

SECTION X: TAX ADMINISTRATION

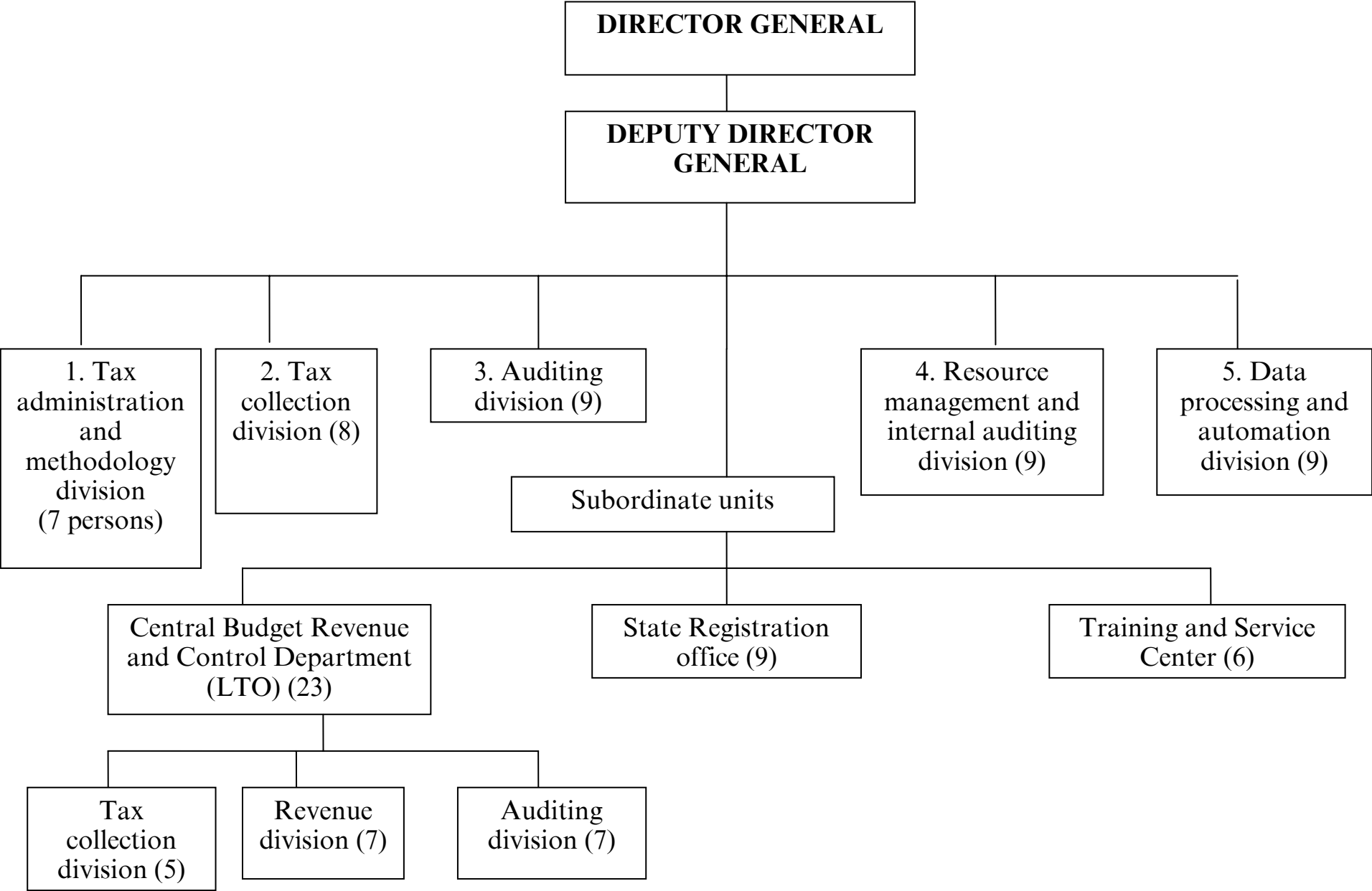
A. Role of modern tax administration

The main function of the modern tax administration is to increase the level of voluntary tax compliance among the taxpayers, instead of making tax assessment. Taxpayer's voluntary compliance means the timely fulfillment of formalities such as registration, issuing invoices, maintaining accounts, preparing statements/returns and submitting to the tax office, paying tax and so on by oneself. Tax administration has to assure whether all potential taxpayers have been registered, whether they have maintained accounting of their transactions, whether they have submitted the statements/returns and whether they have paid the tax or not. Since modern taxes are assessed under the self assessment system, the tax administration must create a conducive environment where taxpayers are capable of fulfilling all their tax formalities by themselves. The tax administration should encourage and reward honest taxpayers and try to transform the dishonest taxpayers into being honest.

As the Mongolian tax administration is young, theoretically it looks much easier to introduce reform measures in this administration than many other traditional tax administrations. The Mongolian tax administration was created as the government agency in 1992. It reports to the Minister of Finance, who, in turn, informs to the Ministry of Finance and Economy. The main objective of tax administration is to implement tax policy and tax laws of the government. It collects both national and local taxes and deposits to the national and local tax budgets, respectively. It also gives inputs to the tax policy division of Ministry of Finance and Economy, which is responsible for formulating tax policy.

Head Quarter of the tax administration was initially created as the General Department of State Taxation which was later renamed as General Department of National Taxation (GDNT). As indicated in Table 10.1, it has five divisions viz; Tax Administration and Methodology Division, Collection Division, Auditing Division, Data Processing and Automation Division and Resource Management and Internal Auditing Division. There are three sub-ordinate units under this department. They are: Large Taxpayers Office (LTO), Training and Service Centre and State Registration Office. State Registration Office carries out registration of entities while individuals are required to register under the LTO.

Table 10.1: Organizational Chart of GDNT



A LTO (Central Budget Revenue and Control Department) was created in 2001 in order to deal with the large taxpayers scattered all over the nation. But the scope of work of this office was expanded in 2002, when it was made responsible for the collection of CIT, PIT, VAT, Excises, and withholding taxes, relating to all taxpayers through local tax offices. It also deals with all kinds of refunds (refunds to taxpayers, foreign aided projects and diplomats). LTO also supervises local tax offices.

There are three divisions of the LTO. They are: collection division, audit division and local tax collection/revenue division. The collection division is responsible for the collection of revenue from about 100 large taxpayers that pay revenue directly to this office. Audit division is responsible for the audit of large taxpayers while local tax collection division is responsible for monitoring and providing guideline to the local tax offices.

There is a training centre, which organizes training programs for tax officials and tax education programs for the taxpayers. It has three instructors responsible for training, one official responsible for tax education and one director. The centre organizes three levels of training programs as follows:

- Initial: Initial training for new entrants for three weeks. Tax officials are trained on some such basic areas as how to receive tax return etc.
- Intermediary: Three weeks training programs on advance topics such as taxation theory, policy and tax audit.
- Advance: These programs are meant for future directors. Some time such programs are conducted with the help of foreign experts.

Training centre also compiles the problems of taxpayers and circulates to each tax offices.

Filed tax offices are established in each Aimag and in Ulaanbaatar city. There are 22 (21 Aimag and 1 UB City) tax offices. They directly report to the GDNT. As Ulaanbaatar city is divided into 9 districts one district tax office is created in each district, which report to the Ulaanbaatar city tax office. Under the Aimag tax offices, there are Soum tax inspectors. Tax administration has about 1200 employees, at all levels.

Another organization responsible for collecting taxes is the customs administration. The central level organization is called Mongolian Customs General Administration. Field offices are called customs offices, which are 27 in number. Of them, 16 are permanent offices while 11 are seasonal offices. These offices are located not only at the border but also inside the country. Inland customs office located in Ulaanbaatar is the largest customs office that collects about 70 percent of total import revenue. Largest seven offices collect about 95 percent of total import revenue. This administration collects import duties, export duties, VAT on imports and excise duties on imports, which was about 30 percent of total tax revenue in 2003.

B. Future directions

Tax administration is a young organization, based on the agency concept. It is independent from the Ministry of Finance and directly reports to the Finance Minister. Total numbers of position are governed by the salary fund. Government approves budget. Tax administration can have few employees and higher salary and *vice versa*.

Tax administration is organized in functional line. Since the central and field level organizational structure follows the same pattern, line of communication is easy. Responsibilities are well defined. Performance standards have been developed. There is a system of evaluating performance each quarter. Further, each year they have test for each tax inspector on tax law, auditing, accounts etc. which tax inspectors are required to know to carryout their activities. If some one does not pass this test, he will be fired.

As the country is geographically very big, it is difficult to control Soum inspectors from the centre. So Soum tax inspectors are located at Governor's office for the local supervision and control, of course, over all control remains in the hand of GDNT

Overall structure of tax administration is good. There is, however, a lot of scope for further improvement. On the basis of our discussion with various groups, we have identified following three areas that need an immediate attention:

- Approach
- Large taxpayers office
- Training and education

B1. Approach:

There is a need to change the approach or focus of tax administration. Currently tax administration gives excessive focus on tax collection. Companies are required to submit their budget for the next income year to the concerned tax office by August this year. Tax offices, in turn, submit these plans to the GDNT. This serves the basis for the revenue estimate for the next year. The annual tax liabilities of each company is divided into 12 months and thus payment schedule for the companies for each month is prepared and sent to the concerned tax office. Companies are required to pay tax each month on the basis of the payment schedule, irrespective of their level of transaction. Field tax officials are given the target, which make every effort to meet the target anyhow. Besides, as their bonus depends upon fulfillment of targets they are encouraged to fulfill their targets. Although there is a possibility to adjust tax amount on the basis of the actual transaction of the current year, in practice, companies are required to pay tax on the basis of the payment schedule.

While revenue collection is important function of any tax administration, it should be collected in a proper manner. Tax administration should make every attempt to implement all major tax functions such as registration, collection, refund, audit and investigation and so on. There is a need to maintain a reasonable level of balance among these functions which will ultimately result in higher collection in a fair and efficient manner.

As tax administration focuses more on advance collection there is not sufficient power of tax administration on the enforcement side. Penal provisions are also not strong. This system also needs to be changed. In the modern tax system, taxes are assessed by taxpayers themselves. For this, tax procedures should be made as simple as possible so that ordinary taxpayers can fulfill their obligations. However, tax administration should be given sufficient power in order to take stringent actions against tax evaders. In this context, tax administrations' power regarding enforcement, including temporarily closer of business, seizure of property, and sale of seized property should be strengthened. It is also necessary to raise penalties.

Tax audit does not seem to be that effective. As indicated in Table 10.2, tax administration has been able to generate about 2 percent of total revenue from VAT, excise duties and income taxes. It is not an encouraging figure.

Table 10.2: Revenue Generated Through Self-Declaration by Taxpayers and Audits

2002 Revenue generated through			2003 Revenue generated through	
	Self-declaration	Audit	Self-declaration	Audit
VAT	41141	605	47031	830
			50424	1437
CIT	44854	1667	27680	700
PIT	22628	995	16188	31
Excises	20368	148	141323	2998
Total	128991	3415		

Source: General Department of National Taxation

It is necessary to strengthen audit function. Since modern taxes are based on the principle of self-assessment, tax audit is absolutely necessary. The objective of tax audit is to evaluate whether the taxpayers have paid the due tax amount as per law. If a taxpayer is found to have paid less tax than the due amount he/she should be made to pay the difference amount. But if the taxpayer is found to have paid more than what is due it should be seen that the excess amount is returned. Tax audit is, therefore, necessary to ensure that taxes are implemented in the right way. For this, tax audit has to be carried out on a systematic manner. Selection of taxpayers for audit should be done on the basis of risk assessment. To carry out tax audit, a time that is convenient to both the tax officer and the taxpayer should be allocated and the taxpayer should be notified in advance to prepare the documentation that would be required. The taxpayer should also provide in time the necessary information and statistics requested by the tax official in relation to tax audit. This will enable a tax audit in a timely manner.

B2. Large taxpayers office

LTO has not been working as a large taxpayer in the strict sense. In additions to large taxpayers, it is also responsible for the collection of corporate income tax, personal income tax; VAT, excises and withholding taxes through local tax offices. It also processes all kind of refunds. It is also responsible for monitoring the local tax offices. Large taxpayers are defined on the basis of invested capital (500 million Tugrigns) which is also not a good criterion. Only about 100 taxpayers have been identified as large taxpayers.

As indicated in Table 10.3, LTO collected total revenue of 89496 million Tugrigns from VAT, income taxes and excise duties in 2003, which was 47 percent of total revenue collect from these taxes.

Table 10.3: Share of Revenue Collected by GDNT from Large Taxpayers to the Total Revenue

Income year	Total Revenue (Tugrigns in million)	Revenue from Large Taxpayer's (Tugrigns in million)	Large Taxpayers share (Percent)
1999	123176	66921	54.33
2000	158496	102831	64.88
2001	188281	114050	60.57
2002	192684	94038	48.80
2003	190060	89496	47.09

Source: General Department of National Taxation.

Following steps should be taken to strengthen the LTO.

- As elsewhere, large taxpayers should be defined on the basis of turnover.
- Number of large taxpayers should be increased in such a way that large taxpayers generated at least 70 percent of total tax revenue.
- LTO should concentrate only on larger taxpayers.

B3. Training for tax officials

While there is a huge need for training, not many training programs have been conducted due to lack of budget. It is particularly difficult to carry out training program for Soums tax officials. There is a generally one tax inspector in each Soum. To bring him to Aimag is costly. Besides, since there is only one official, no one would be in Soum to carry out tax functions when he or she is on training. So it would be necessary to develop some methods of distance learning. Trainings are organized once in two years for the Aimag officials, particularly on the amendments to the tax laws. There is a uniform course for heterogeneous group, which is not that useful. This needs to be changed.

Importance of training was also highlighted during our several meetings. Training would be even more important in the context of the proposed comprehensive reform of the tax system. It will be necessary to organize many orientation programs for higher level officials on the rationale of tax reform measures. Similarly, it will be necessary to organize many training programs for the tax officials on the tax laws and tax procedures. It would also be necessary to send abroad some potential dynamic managers for training for longer period in order to impart knowledge of good tax policy and best administrative practices. It must be noted that Mongolian tax administration has completed its transition. Now it is necessary to look for new things. For this tax collectors need to be trained on new ideas and new techniques.

It will also be necessary to prepare operating manuals, publish them and distribute to all tax offices in order to facilitate their day to day work and to maintain uniformity in the imposition and collection of taxes in all tax offices.

C. Tax compliance

Since Mongolia has a modern tax history of about only a decade, it is expected that the level of tax compliance among the people is not high. During our meetings, various people mentioned that many are not aware of their tax responsibilities. Some comply with

tax laws but others not. As a result, those who comply feel that they are being penalized. This may discourage them to comply in the future, which may reduce the level of compliance. Mongolian tax administration faces formidable challenges to raise the level of tax consciousness amongst Mongols. It should adopt both motivating and punishing measures to raise the level of tax compliance among the taxpayers.

C1. Motivating measures

At present, all the important taxes are based on the principles of self-assessment. In order to make the self-assessment system more effective, a comprehensive taxpayer education and service program must be conducted and the taxpayers must be provided support in fulfilling the formalities. In this process, the taxpayers must be made aware of their rights and responsibilities. Such an effort would increase taxpayers voluntary compliance, reduce compliance costs and generate awareness about all the formalities related to tax.

(A) Simplifying the tax structure and procedures

The tax structure and procedures must be made simple and transparent. In this context, the number of taxes should be limited. Attempt must be made to implement a few broad based taxes instead of levying many different taxes under various names. Further, the level of tax rates and the numbers must be low. Formalities related to tax such as registration, accounting, preparing statement/return and paying tax must be made as simple as possible. The common taxpayer should understand the various forms to be filled by them and they should be given instructions on how to fill the form.

The main law related to tax must be detailed, simple and clear and it should not be changed from time to time. If the tax law lacks details or if it is changed from time to time with the implementation of new measures, both the taxpayers and the tax administrators may lack clear knowledge of the same. In this situation, the taxpayers will not be able to fulfill the formalities related to tax. Therefore, it is necessary to maintain permanency in the tax laws in order to increase tax compliance and to implement the tax system effectively. The processes must be mentioned in the regulation or the operating manual. Departmental circulars and notices must be used less often and they should be made public.

(B) Conduct taxpayer education campaign

Mongolian tax system is young and growing. So it is difficult to know about the system by both taxpayers and tax collectors. It is therefore necessary to organize training for tax officials and tax education campaign for taxpayers.

In order to raise the level of tax consciousness among the citizenry they must be made aware of topics such as what is tax, why does the government impose tax, why do they have to pay tax, what are the benefits of tax to the society, what happens if tax is not paid, what happens to defaulters. The high publicity of the tax structure and the procedures will result in more knowledge of tax among taxpayers, increase in the trust in the tax system and tax administration and increase in tax compliance.

The taxpayers must be made aware of their rights and responsibilities. Similarly, tax related professionals such as lawyers, accountants, and auditors must be made aware of various aspects of tax. Then they can, in turn, make the taxpayers aware of the tax system.

Taxpayers must be properly informed while imposing new tax or while implementing new processes in a prevalent tax. The following factors must be made in order to make the taxpayers aware of tax:

(I) Taxation should be included in the school/college/university curriculum since the knowledge gained in the young age remains deep rooted and the students will be able to convince their parents for tax compliance.

(II) It will be difficult for the general public to understand the whole Tax Acts no matter how simple the tax law is designed. It is not necessary for them to understand the whole Acts, either. Various brochures, booklets, pamphlets, leaflets with various aspects of tax in simple language with examples must be developed and distributed to the taxpayers. All the formalities of the taxpayers must be mentioned in a simple manner in these materials. Reading materials with simple language must be developed on taxable items, how to maintain accounting of tax, how to prepare the tax returns. These publications must be placed in public places such as Tax Office, National Chamber of Commerce and Industry, Professional Associations, Bank, and Post offices for free distribution.

(III) Tax bulletins must be published regularly which should contain various notices, information and answers to often asked questions.

(IV) Notice must be published regularly in the newspapers regarding date of submission of statement/return and paying tax.

(V) A video cassette of the main formalities of the taxpayers related to various taxes must be produced and transmitted.

(VI) Radio and television programs related to tax must be conducted.

(VII) Taxpayers friendly visits must be organized regularly. There will be changes in the processes related to tax and new taxpayers will come into the tax net every year. Therefore, taxpayers' friendly visits must be organized to check whether the taxpayers have properly issued invoices, maintained accounts, filled the tax returns, and paid taxes. If the processes are not correct, the taxpayers must be taught the right process. The taxpayers must be given written information and a copy of this must be maintained at the tax office.

(VIII) Workshops and interaction programs related to tax must be organized.

(IX) Various articles regarding the importance of tax, structure and working procedures must be published in the newspapers.

(C) Service/support to taxpayers

The tax administration must provide whatever support is required by the taxpayers in order to fulfill the tax formalities. For this purpose, taxpayer service program must be developed as a campaign. In this context, taxpayers service centre must be established in the tax administration.

Taxpayers should not face any difficulties while paying tax. An environment to pay the tax simply and easily must be created. This situation can be maintained through the support of the taxpayers service centre.

In this context, the following activities must be conducted:

- Tax education materials must be made easily available. The various forms must be easily available whenever required at an appropriate place and free of cost.
- An important aspect of the tax administration is to provide full support to the taxpayers. In this context, support must be provided to those who cannot complete the statement or to those who do not understand the processes.
- The taxpayers' service centre must provide information of which section or which person to contact for a particular work/quarry of the taxpayer.
- Appropriate answers must be given to those taxpayers who ask questions through the telephone.
- Timely answers must be given to written questions.
- Decisions must be made swiftly understanding the difficulties of the taxpayer.
- While taking actions against a taxpayer, the tax administration must provide information to the taxpayer about the concerned brochures, the rights of the taxpayer, who to contact if the taxpayer is not satisfied with the decision of the tax administration, how, where and when to appeal. If a form is required by the taxpayer, it must be made available.
- The tax administrators must talk nicely with the taxpayer and behave with respect and impartiality.
- Such programs will decrease court cases and compliance costs and administrative cost of tax collection.

(D) Others

The motivation to pay tax among taxpayers will develop if the tax amount is spent on programs which benefit the taxpayers and they should be made aware of the use of tax money.

Tax law should be implemented equally and effectively in all sectors in order to increase the level of tax compliance. Honest taxpayers should be rewarded. The tax administration must be able to create an environment where honest taxpayers always remain honest. For this purpose, tax laws should be implemented effectively so that dishonest taxpayers are discouraged and transformed into honest taxpayers. Honest taxpayers must be taken as important clients in order to increase tax compliance and the tax administration must make special efforts to transform dishonest taxpayers into honest taxpayers. The tax administration must be able to develop the trust among taxpayers that the laws related to tax will be implemented effectively and honestly.

C2. Punishing measures

Among the total number of taxpayers, not all are honest in any country. Some potential taxpayers attempt not to come into the tax net and others may be registered but do not submit the tax statement/return on time, pay the tax on time, accurate accounting is not maintained, correct statement/return is not submitted and some do not pay the tax on time. If the tax administration does not take action against these taxpayers, taxpayers who fulfill the formalities on time will feel that the administration is not providing justice to them. The reason is because the taxpayers that fulfill the formalities on time will have to pay tax and bear the compliance costs whereas others will not bear such costs and not pay the tax. This will create unhealthy competition among the taxpayers. The taxpayers of the

justice and will gradually be forced to conduct their transactions undercover. In this situation, the formal sector of the economy will be compressed and the informal sector will expand and none of the tax system will survive.

In order to avoid this situation, the tax administration must take strict actions against dishonest taxpayers. The taxpayers should feel that the tax administration will discover and take strong actions if they remain outside the tax net or if they do not pay the tax accurately. For any tax system to be implemented correctly, the feeling that the tax administration is capable, impartial, can implement the laws related to tax effectively should be generated. Environment should be created where high penalties are imposed on those who do not fulfill the tax formalities.

In this context, the tax administration should do the followings:

- Bring all potential taxpayers into the tax net by conducting a survey of potential taxpayers every year.
- Enforce the issuance of invoice on those who do not issue invoices.
- Ensure proper and accurate accounting among those who do not maintain proper accounting.
- Ensure that all taxpayers submit the income statement/tax return through continuous reminders.
- Ensure that tax is paid by those who do not pay tax.
- Conduct tax audit and investigation.
- Increase the activities related to tax collection.
- Punish tax defaulters.

C3. Tax amnesty

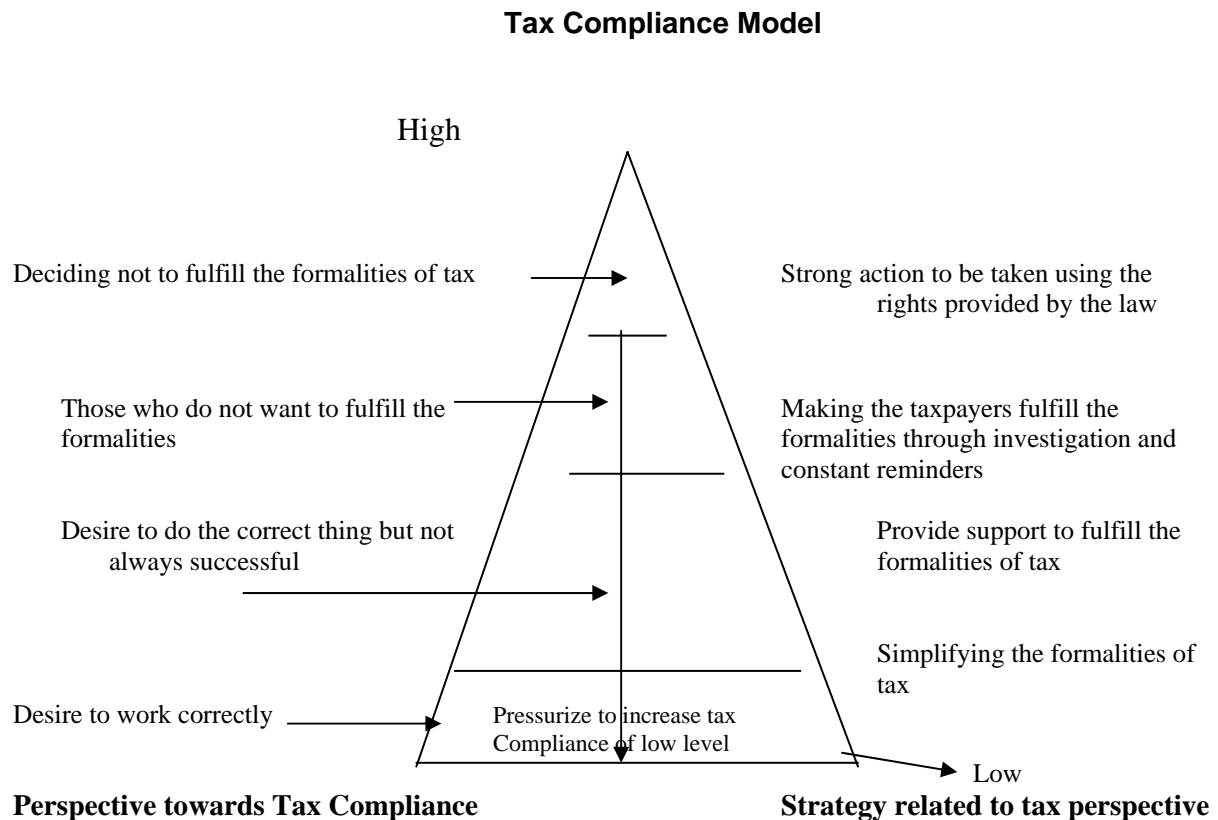
In order to increase the taxpayers voluntary compliance, at times tax amnesty is given on penalty, fine and interest due to non payment of tax, lack of accounting, lack of submission of statement or not fulfilling some other formalities in the past and generally a lower tax is imposed. For example, India and Nepal introduced a voluntary disclosure of income system in the recent past, where taxpayers were allowed to disclose their income and pay some tax and then be the regular taxpayer. The objective of this is to create an appropriate environment to bring those taxpayers who were not inside the periphery of tax due to various reasons in the past into the tax net. This is a plan to rectify the past mistake and to start afresh. This is particularly done at a time when a country embarks on a comprehensive tax reform package or introduces a new tax law. It is believed that such a practice will increase the taxpayer's voluntary tax compliance.

This may also be worthwhile trying in Mongolia to bring some businesses or individuals in the tax net. As Mongolia has not a long history of modern tax system, one cannot expect very old chronic cases of non-compliance. However, some businesses, professionals etc. are believed to have remained out side the tax net in the last one decade or so. It will, therefore, be necessary to grant tax amnesty and bring them into the tax net.

Tax amnesty, however, must not be given from time to time. This trend will develop a feeling among the taxpayers that the government will again give tax amnesty and they will not be motivated to fulfill the tax formalities. This instead of increasing voluntary tax compliance may in stead decrease it. This will make the tax system unequal and decrease revenue. So tax amnesty should not be given from time to time. Tax administration should take stringent actions on those who do not come into the tax net voluntarily even after the implementation of the tax amnesty scheme.

C4. Strategy

Among the above mentioned promontory and punitive measures, an appropriate strategy must be incorporated on which measures are more effective for which situations. Some taxpayers may have to be provided more knowledge of tax, the simplification of the processes may be appropriate for others and strict action may have to be taken for others. In this context, tax officials should follow the following tax compliance model.



Most of the people in the society want to do the right work. The rules and regulations that they have to follow must be made simple. Most of the people will follow the laws and processes related to tax if they are not complex.

Some people want to do the right thing but they may not be successful all the time. Those people should be provided support by the tax administration. This will increase their tax compliance.

Some people do not want to fulfill tax formalities. The tax administration should find such persons and make them fulfill tax formalities. For example, if the tax administration finds those individuals who do not register on time or who do not submit the statement/return or who do not pay tax on time, remind them constantly or take minor action, in future they will comply with the tax.

Some people may have decided not to pay the tax. The tax administration must take stringent actions through the use of full rights provided by the law on such taxpayers. If action is not taken against them, the level of tax compliance of other taxpayers will decrease. Therefore, strict action must be taken against tax defaulters in order to generate the feeling that they will have to bear large costs if they do not comply with the tax. The

impact of this should be able to maintain a high level of tax compliance among other taxpayers.

To sum up, the Mongolia tax system is relatively young and changing. Under these circumstances, taxpayer education program has to be taken as a campaign in order to make the taxpayers aware of the taxes. Instead of punishing those who make minor errors unwittingly, a policy should be adopted to teach them about the tax and assist them in fulfilling their tax liabilities. On the other hand, strict measures must be taken against those who evade tax intentionally. If strong action is not taken against such defaulters, there will be revenue loss and the tax system will be unequal. A right balance needs to be maintained between promontory and punitive action in order to increase the voluntary compliance of the taxpayers and the possibility of the tax laws being implemented equally in all sectors.

D. External assistance

It would not be possible for tax administration to carryout many reform activities due to the lack of resources. It has not been able in the past to conduct even minimum training programs due to the lack of budget. Implementation of tax reform measures would require additional resources. This would require outside funding.

SECTION XI: TAX POLICY FORMULATION AND IMPLEMENTATION PROCESS

A. Long term strategy

Taxation is a sensitive area. On the one hand, it is necessary to levy taxes, mainly to generate revenue which is required to finance both traditional (maintaining security and law and order and protecting the country from external invasion) and modern functions (development of economic and social overhead, establishing social security system, for example) of the government. On the other hand, taxes generate costs to the economy. First of all, the amount of tax collected by the government is a cost to the economy as it is paid by various players of the economy. The cost of taxation is not limited to the amount of revenue collected only. It generates additional costs as well. For example, there is a need to create tax administration to collect tax which generates cost of tax collection. Similarly, in connection with the fulfilling tax formalities taxpayers have to bear costs, which are known as the compliance cost. Besides, tax also generates economic costs by bringing undesirable and unintended changes (distortions) in the economy.

Every attempt must be made to generate revenue through the minimum cost of taxation to the economy. For this, it is necessary to make a correct analysis of the impact of any tax proposals on the industry, trade or profession. It requires a detailed study as well as wider consultation with the stakeholders.

On the basis of such a study, a long term tax strategy must be designed. Tax reform measures to be introduced over a period of time need to be approved and published. So every one knows what is going to happen when and can adjust his/her activities accordingly. This would make the investors aware of the tax policies so that they can plan their projects accordingly. It will bring certainty, which is one of the fundamental canons of good taxation developed by Adam Smith many years ago and a recent practice which has been adopted by more and more countries in the recent past. Mongolia should also gradually graduate to the same system.

Tax proposals every year should be prepared as per the long-term strategy. The proposals implemented every year must contribute towards the evolution of a good tax system. This kind of tax system alone would be sustainable in the long-run and would not require quick changes. Since this kind of tax system is appropriate economically, administratively and from other viewpoints, it is very important for Mongolia as well to formulate the tax structure and operational processes after a detailed study.

B. Policy formulation

According to the Constitution of Mongolia, the President, members of the Parliament and the Government have the right to initiate law. Citizens and other agencies/organizations may forward their suggestions on proposed laws to those entitled to initiate law.

Law on Government indicates that the draft law shall be discussed by the Cabinet Meeting. Therefore draft law initiated by the president or a Member of Parliament is sent to the Government (Ministry of Justice is responsible to scrutinize the draft law in conformity with other legislation as well as the necessity of such law, and collect opinion of other ministries on that draft law, and submit for the Cabinet Meeting). The same procedure applies to the draft law initiated by the Government.

If the draft law is supported by the Cabinet Meeting, it is submitted to the Parliament. But the Government also has a right to reject or suspend the draft law. If the Government does not agree with the draft law initiated by the President or a Member of Parliament, the draft law shall be presented to the Parliament for discussion. Parliament, in turn, forwards

the draft law to the Standing Committee on Economic Policy of the Parliament, where they are discussed thoroughly. Then the committee sends back its report to the parliament, which makes a decision to adopt, to suspend or reject the draft law. Once the draft law is approved by the Parliament, it is sent to the President for his/her approval, which can either approve or reject. The President has a right to veto to reject a law partially or in its entirety. The parliament shall discuss the President veto, and if 2/3 of the Members of Parliament do not agree with the veto, the decision of the Parliament shall stay as in effect. The Parliament is responsible for publishing adopted laws, and if it is not provided by law, the law shall be in effect after 10 days once published.

It looks that tax policy formulation process is rather closed. Such an approach suffers from a number of limitations. If the tax policy formulation process is limited to a few individuals and if the new proposals are not discussed with experts, intellectuals, industrialists, businessmen, professionals and, more importantly, with the members of the civil society, these proposals will not have a chance to be fine-tuned. Proposals, which are implemented without detailed study, intensive interaction and lack of consent from various sectors, will merely ensure quick changes instead of being sustainable to any point. Or, they will not be implemented at all. This kind of proposals will have negative impact on the private sector and taxpayers will lose trust in the tax system and tax administration and in the end such proposals will be un-productive. It is, therefore, necessary to establish a system of first carrying out a detailed study in order to develop new proposals and then conducting a detailed discussion on them at various levels. This would ensure that the tax proposals are deemed practical and can be implemented in real life, which, in turn, will increase the confidence of taxpayers and others in the tax system and tax administration.

C. Policy introduction

After the approval of the president, new policy/laws or amendments to the existing policy/laws are published immediately by the Ministry of Justice and the Law Centre. The laws are implemented within 10 days of their publication. But if the date of enforcement is mentioned in the law itself, then they will be effective from that date. In either case, they are implemented within a short period, leaving not enough time to educate tax officials, taxpayers and others about the changes.

Such a practice of introducing new laws gives rise to various practical problems since the regulations, directives and so on are often not ready by the time the new policy/law is implemented even as the tax administrators would not have received any training while the taxpayers, too, are not aware of the new system. In order to avoid this, the act should be implemented on a specified date and date should be determined after all the preparatory work has been completed. Before the implementation of the law, regulations should be prepared, working manuals should be developed, tax officials must be trained and taxpayers should be educated. It is the responsibility of the tax administration to make the concerned sector aware before implementing anything. This will ensure effective implementation of the tax laws.

D. Policy execution

The introduction and the execution of a new system need to be looked into in separate light. The initial stage of the introduction of a new system should be taken as a learning period. During this period, taxpayers' education program should be conducted on a campaign footing in order to generate awareness among potential taxpayers and other sections of society. If a taxpayer does not fulfill some formality in the desired manner,

he/she should be handed written information instead of imposing fines with the warning that he/she would be punished for the same mistake in future. Most of the resources

should be spent on tax training and tax education during this time. Once this period is over, tax administration then should change its strategy and focus more on the execution of the system. It should then spend its more resources on monitoring, audit, investigation. Penal provision should be applied strictly to those who do not fulfill the formalities in deliberate manner after the initial phase.

E. Institutional arrangement for policy formulation

Different countries have adopted different institutional set ups for the formulation of tax policy. Some countries have tax policy division in the Ministry of Finance which is responsible for the formulation of tax policy. Mongolia follows this approach where, there is a Revenue and Tax Policy Division in the Ministry of Finance and Economy. Such a job is carried out by a Permanent Tax Advisory Body in Japan. Some countries also constitute special commissions, committees or task forces etc. to recommend tax policy measures. Whatever may be the structure of such a body, depending upon the local conditions, it should focus on the followings:

- Extending suggestions to prepare new tax proposals;
- Analyzing and forecasting revenue;
- Supporting the government in formulating and updating tax policies;
- Extending suggestions for reform in tax related laws;
- Extending suggestions to make the processes related to tax more practical, simple and transparent;
- Extending required suggestions for the reform in tax administration;
- Submitting reports to the government from time to time through the review of tax policies and research on whether they have been implemented correctly

It is very crucial for Mongolia to revamp its Revenue and Tax Policy Division in the Ministry of Finance and Economy or to create a specialized organization in order to carry out above mentioned activities in a meaningful way.

SECTION XII: LEGAL FRAMEWORK

A. Evolution and issues

Tax laws were introduced in the early 1990s, right after the political change. Some laws have been changed over the time perhaps to solve some practical problems. Some laws such as customs laws and VAT law are quite comprehensive and compatible with the international standard. Mongolia has been able to set up a fairly good legal system in a relatively short period.

However, not all laws are sufficiently detail as they were introduced within a short period without much study, consultation, discussions and preparation. Further, as these laws were drafted in the early stage of transition from a controlled economy to a market economy they are in many respects influenced by socialist concepts, which is understandable.

Some tax laws lack different important elements of modern tax laws. Particularly, CIT Law, PIT law and immovable property tax law are brief and do not contain several elements of modern income tax system, opening scope for interpretation and conflict between taxpayers and tax collectors. Inadequate legal provisions also create need to issue departmental circulars, guidelines etc. frequently which may not always be perfect and are not easily available to a common businessman. Income tax laws do not follow the conventional structure, either. For example, under a modern income tax one can expect first definitions, imposition of tax, tax rate, sources of income, deductible expense, depreciation, loss carry forward, accounting system, special provisions relating to certain sources of income, international taxation, record keeping, tax assessment, submission of income statement, payment of tax, collection, refund, withholding, interest, penalty and appeal, divided into different chapters, sections and subsections. It is not the case with Mongolian income tax laws, which makes the life of both tax administration and taxpayer more difficult. The current structure/contents of Mongolian CIT act and PIT act is given below:

ECONOMIC ENTITY AND ORGANIZATION INCOME TAX LAW OF MONGOLIA

- Section 1. Purpose of law
- Section 2. Economic entity and organization income tax legislation
- Section 3. Taxpayer
- Section 4. Type of taxable income
- Section 5. The Sectoral Classification of All Types of Economic Activities
- Section 6. Tax rates
- Section 7. Tax Exemption and Relief
- Section 8. Tax payment and return
- Section 9. Entry into force

PERSONAL INCOME TAX LAW OF MONGOLIA

- Section 1. Purpose of law
- Section 2. Personal income tax legislation
- Section 3. Taxpayer
- Section 4. Taxable income
- Section 5. Definition of taxable income

Section 6. Definition of taxable income of animal breeders
Section 7. Tax rates
Section 8. Special tax rates
Section 8*. Special tax rates on income of temporarily or non-resident taxpayers
Section 9. Tax credit and exemption
Section 10. Tax imposition and transference of it to the budget
Section 11. Term of submitting return
Section 12. Entry into force

There are only 9 sections (about 9 pages) of the CIT law and 12 Sections (about 10. pages) of the PIT law. These are shorter than even the world's first income tax law, which was introduced in England in 1799, not to talk about any modern income tax law. It is therefore, necessary to amend these laws to include basic elements.

Another deficiency found in the Mongolian income tax law is that while some substantive matters such as deductions, valuations etc are not included in the law; some trivial matters such as registration process are included in the law.

Similarly, immovable property tax law is very brief and does not cover several element of the law. This law also needs to be amended considerably.

There are too many tax laws. There are two general tax laws viz.; the General Tax Law of Mongolia, and Law on Imposing Tax, Supervision, Tax Payment and Tax Collection. There are specific tax laws on various taxes. In the case of customs duties, there are two laws, which is not a common practice around the world. There are two income tax laws. While it is not uncommon to have separate laws for CIT and PIT, attempts must be made to harmonize these two laws. If there are significant differences regarding the system of allowable deductions, depreciation, loss carry forward, tax exemptions etc. that affect tax base and consequently tax liability, taxpayers may change legal status of their business to switch from PIT to CIT law or *vice versa*, not for nay economic reasons but to lower the tax liability, which is now the case in Mongolia.

Not only there are different tax laws, but tax related provisions have also been scattered in many non-tax laws, such as Foreign Investment Law, Mining Law, and Petroleum Law, leading to some time even conflicting and contradictory provisions. For example, carry forward and deduction of Research and Development expenses are included in the Mining Law. But as such provisions are not included in the tax laws, tax officials disregard them, leading only to conflict between taxpayers and tax collectors. .

As there are too many laws (see Annex M), and too many amendments the legal system is complicated. It is difficult to have an over view of the whole tax system. This, *inter alia*, increases cost of doing business and only makes Mongolian economy less competitive.

B. Immediate actions

Tax laws should be made comprehensive, clear and transparent. They should have all basic elements of tax laws. There should be a minimum use of administrative circulars, guidelines etc. In this context, it is necessary to:

- Gather tax related provisions from different tax and non-tax laws
- Identify duplications and inconsistencies/contradictions in various laws
- Indicate areas where there is a need for clarity
- Indicate provisions that do not follow standard principles/practices

- Prepare guidelines for matters that need to be included in tax laws, tax regulations and ministerial/departmental guidelines or notifications
- Recommend for suitable amendments in the existing laws

B1. Long-term perspective

The existing structure would need several changes; if they are introduced in a piecemeal basis it would be necessary to introduce changes over a long period of time, which is not good from an economic and administrative point of view. Besides Mongolia has to compete or deal with many others countries. So it is necessary to develop tax laws and system that are internationally competitive. Such a transparent legal system will be required also to attract foreign investment.

Desirable path would be an overhaul of legal system, by replacing existing numerous laws by one comprehensive tax code. Tax related provisions which are included in the several non-tax laws, which are not effective any way, should be included in the tax code. The first part of the tax code may include the structure and unique elements of various taxes and the second part may include tax procedures which may mostly be common for all taxes.

Such a comprehensive, clear and transparent tax would make every ones life easier. It will facilitate day to day work. There will be less scope for interpretation and dispute between taxpayers and tax collectors and less scope for the misuse of the tax laws and less opportunity to take undue advantages by some scruples personals.

Following long-term actions have been recommended:

- A law reform task force should be created. This task force should be assisted by expatriate.
- A comprehensive tax code, regulations, forms, operating manuals, brochures, teaching materials and training need to be developed.
- Several training programs for tax officials and a comprehensive tax education program for taxpayers on the new legal system will have to be organized.

SECTION XIII: SUMMARY AND RECOMMENDATIONS

A. Summary

In Mongolia, modern tax system was established in the early 1990s, after the political change in 1990. Several taxes were introduced one after another. For example, customs duties were introduced in 1991, CIT, PIT, excise duties, stamp duties, vehicle tax and sales tax were introduced in 1993, gasoline and diesel fuel tax was introduced in 1995, land fees were introduced in 1997, and VAT replaced sales tax in 1998 while immovable property tax was introduced in 2001. Social security contributions were introduced in 1994.

While CIT is levied with two rates: 15 and 30 percent, PIT is levied with three rates, 10, 20 and 30 percent. There is no basic allowance under the PIT. Taxpayers, however, can claim an annual tax credit of 48,000 Tugrigs. PIT is also levied with different special rates on specified sources of income. Tax is withheld on dividend, interest, royalties etc. Social security contributions are levied at the rate of 19 (20 or 21, depending upon the nature of work) percent on employers and 10 percent on employees.

VAT is levied on all goods and services, except exempt specifically by law. The tax is collected at all stages in the production and distribution process. The registration threshold is 10 million Tugrigs. Tax rate is 15 percent while exports are zero rated. Excise duties are levied on the imports as well as domestic products of gasoline, vehicles, alcoholic beverages and tobacco products with specific rates. Import duties are levied on a large number of imported goods at a flat rate of 5 percent while export duties are levied on a few items such as wool, cashmere, goat-skin, logs, wooden materials and mining products with specific rates.

Immovable property tax is levied at the annual rate of 0.6 percent while vehicle tax is levied with varying specific rates, depending upon the type of vehicles. Gasoline tax is levied at specific rate on both imported as well as domestically produced petroleum and diesel.

In addition to these taxes, some other charges such as royalty, forest income, fees or payment for natural resources, which are generally included under the non-tax heading in other countries, are levied as taxes in Mongolia. Besides, there are some non-tax sources, which are collected in the form of income earned by budgetary organizations, central bank's profit, dividend, interest and rent.

Revenue is divided into two groups: tax and non-tax. Tax revenue is further divided into income tax, social security contributions, property tax, domestic trade taxes and international trade tax.

Tax revenue constitutes about three fourth and non-tax revenue one fourth of total revenue. Of the tax revenue, domestic trade taxes provide about half of total tax revenue. It is common in many developing countries. But what is uncommon in Mongolia in comparison to many developing countries is the share of income tax and social contribution and international trade taxes. In many developing countries international

Trade taxes still provide bulk of total tax revenue while income taxes are not that important from a revenue point of view and social security contributions even do not exist. But in Mongolia while international trade taxes provide less about 8 percent of total tax revenue due to the adoption of a low level of import tariff in the context of more open and liberal trade regime adopted by this country which is good, income taxes and social

security contributions jointly provide more than one third of total tax revenue, which is high and deleterious to the economic development.

Non-tax revenue contributes about one-fourth of total tax revenue. While in general non-tax revenue cannot be used as an effective instrument of revenue mobilization, in case of Mongolia natural resources have a large potentiality to generate government revenue.

In 2003, Mongolia's tax/GDP ratio was 29.7 percent which is comparable to the tax/GDP ratio of those countries that have a per capita income of more than US\$ 6,000. Mongolia's per capita income is less than US\$ 500, a country that generally fall in the category of country that have a tax/GDP ratio below 15 percent.

The General Law of Taxation was introduced in 1993, which established the basis for the imposition of taxes. This law assigned the tax base to the central and local level governments. A new law on imposing tax, supervising tax payment and tax collection was adopted in 2002. As the name indicates, it deals with the levy of various taxes and supervisions of their payment and collection. In additions, there are several specific tax laws that govern a particular tax. Many laws have been amended several times over the years.

Tax administration is a young organization, based on the agency concept. It is independent from the Ministry of Finance and directly reports to the Finance Minister. Tax administration is organized in functional line. Since the central and field level organizational structure follows the same pattern, line of communication is easy. Responsibilities are well defined. Performance standards have been developed.

There are 22 tax offices, 21 Aimag and 1 Ulaanbaatar City Tax Office. There are 9 district tax offices under the Ulaanbaatar tax office while Soum tax inspectors under the Aimag tax offices. As the country is geographically very big, it is difficult to control Soum inspectors from the centre. So Sums tax inspectors are located at Soum Governor's office for the local supervision and control, of course, over all control remains in the hand of GDNT. There are about 1200 employees in the whole tax administration.

Customs administration collects customs duties and VAT and excise duties on imports through 27 customs offices, out of which 16 are permanent offices and computerized.

Overall structure of tax administration is good and taxpayers have noticed improvement in the tax administration in the recent years.

Mongolia has been able to establish and develop a fairly good revenue system in a relatively short period and has been generating revenue more effectively than many other countries that have a much longer history of revenue collection than this country. There are, however, some issues that need an immediate attention.

- Tax measures have been introduced one after another on a piece meal basis, without carefully examining their effect on the economy. Tax changes were either intended basically to fix some specific administrative problems or to satisfy some groups. For example, various experiments have been made regarding taxation of gold. While some exemptions granted under VAT were abolished but at the same time new exemptions were introduced. Foreign investors have been granted various incentives, including the exemptions of VAT and customs duties on the import of foreign investors, which are hard to justify.

- There is a lack of balanced approach. Tax provisions are too liberal in some areas while too conservative in others. For example, Mongolia has moved very fast in the field of customs duties reform, by adopting a uniform low rate tariff of 5 percent. On the other hand, even basic business expenses are not deductible under income taxes, which are subject to high rates.
- Mongolia's tax to GDP ratio indicates that it is one of the highest taxing countries. This may be clear from the comparison of tax/GDP ratio with similar, developing and advanced countries. High level of taxation is partly due to the high rates and partly due to the tax assessment and collection procedures. For example, until 2003 the top rate of PIT and CIT was 40 percent, which was reduced to 30 percent in 2004. On top of it, social security contributions are levied at the rate of 29 percent (19 percent employer and 10 percent employee). Taxpayers are not allowed to deduct several business expenses. There is no provision of loss carry forward/backward, either. Further, businesses are required to pay an advance tax on the basis of the estimates submitted in the previous income year.
- Different sectors of the economy are being treated in a different manner. For example, there are different tax treatment for labor and capital, big and small companies, effect of dual rates, import and domestic products foreign investment/domestic investment and so on. As a result, tax system generates large distortions in the economy and has become horizontally inequitable.
- Fiscal system is very much centralized. Policy and administration of so-called local taxes is totally central while revenue from these taxes goes directly to the local budget. On the other hand, assignment of the tax base to the local governments does not seem to be proper. Tax levied on persons, such as income tax, inheritance and gift tax are not good members of the local tax system. While the PIT was taken out from the list of local taxes and added to the list of national tax in 2002, inheritance and gift tax has still been grouped as a local tax, although this tax has not been implemented yet. Similarly, taxes on natural resources may be central rather than local.
- Many pieces of laws have been introduced over the years. Not only there is a separate law for each tax, but there are two laws governing the same tax. Similarly, there are two laws of general nature: the General Tax Law of Mongolia, and Law on Imposing Tax, Supervising, Tax Payment and Tax Collection. Further, tax provisions have been spread in many other non-tax laws, sometimes inconsistent. It is not easy to obtain an over view of overall tax system. For example, the tax appeal system is governed by at least seven laws. On the other hand, some laws, particularly income taxes and immovable property tax laws are very brief. They are, however, not as incomplete as they sound since tax collections, penal and other provisions are covered by other tax laws. But still they do not cover substantial part of the modern tax laws. Tax administration face problem in day to day work due to inadequate provisions. Tax officials cannot respond the queries of taxpayers properly because the laws are not adequate. Some taxpayers take undue advantage of the insufficiency of the law. Further, these laws do not follow conventional structure.
- Some charges which are generally classified as non-taxes in the international arena have also been included in the tax group in Mongolia.

- While tax administration has been established under a very modern agency concept, tax collection procedures, such as payment of tax on the basis of the budget already submitted last year, are influenced by the socialist concepts. Exposure of tax administrators to good policy and best administrative practices is limited.
- Tax policy and law formulation process is not much participatory and level of tax education is rather low.

B. Recommendations

The above discussion indicates the need for the restructuring of the overall tax system and strengthening and reorienting tax administration. A comprehensive tax reform package needs to be introduced. It is politically a good time since the parliamentary election was conducted recently. Political parties, which are committed for a great unity, have made several commitments and people have many expectations and aspirations. There is also scope to simplify tax system in many ways including, allowing full business deductions under the income taxes, providing full input tax credit under VAT, speeding up refund process, slashing income tax rates, simplifying return submission and tax payment procedures and so on. These measures are not expected to encounter political difficulties.

However, it is very crucial to maintain an overall balance in order to establish and maintain a sustainable and sound fiscal system. For example, rate reduction of income tax/social security contributions should be accompanied by base broadening, which basically means abolishing tax concessions/incentives granted under income taxes, VAT, customs duties and excises. It will be necessary to broaden the base of excise duties by bringing new items in the tax net. It would also be necessary to raise excise rates on items which are already in the excise net. Attempts also must be made to generate more revenue from non-tax sources. Income tax rate reduction should be accompanied by an increase in the rate of royalties. These reforms should be announced as a package so that it will be easy to sell overall tax reform package. It will be easy to sell the idea of base broadening at time when the government has some leverages to reduce tax rates, allow deductions and simplify tax procedures. If rates are reduced without broadening tax base, later on it will be even more difficult to eliminate concessions.

Of course, not all measures can be implemented at once. They need to be implemented over a period of time. One has to take into account political realities and administrative capabilities. Revenue implications are equally important, which suggest for a step by step approach. It will be necessary to sequence revenue measures and prepare a long term revenue strategy. The revenue proposals every year must be introduced as per the long-term strategy and should help establish a good tax system over a period of time. Administrative reform should be an important element of tax reform package. Design of good laws and rationalization of tax structure is not an end itself. It must be implanted properly and effectively. For this, it is necessary to reform tax administration. Tax administrators should be trained on the new system. They should be familiar with the rationale of new provisions in order to defend or educate people at large on the new system. It is equally important to educate taxpayers, professionals, lawyers, chartered accountants, auditors and so on. This must be supplemented by operating manuals, brochures, and other tax education programs.

Recommendations relating to specific tax, non-tax and other areas are given below:

B.1 Income taxes

- Unify CIT rates and levy it in the neighborhood of 20 percent, in a phased manner.
- The number and level of personal income tax rate should be reduced in a phased manner and finally a uniform rate may be levied in the neighborhood of 15 percent.
- Simplify the rate structure applicable to specific sources of income.
- Reduce the rate of withholding tax and make them compatible with treaty rates, in the case of non-residents.
- Introduce basic allowance system or increase tax credit amount; former is more attractive from an administrative point of view while the latter is more attractive from an equity point of view. There will not be much difference between allowance and tax credit when PIT will be levied at a flat rate.
- Allowances for transportation, food should be treated as allowable deductions at employers' level and taxable at the employees' level.
- Elective final withholding, or tax on dividend distributed from exempt income only or reduction in the dividend tax rate to 10 percent may be adopted in order to reduce the burden of tax on dividends. Reduction in the rate is the most attractive from an administrative point of view.
- Make all businesses expenses, including customs duties, capital repairs, damages caused to third party, insurance (if not mandatory), relating to taxable income deductible.
- Remove cap of 10 percent for the total deductibility for advertising, promoting and training.
- A pooled system of depreciation with diminishing balance method (straight line method for intangible assets) may be adopted.
- Loss carry forward should be allowed, at least for five years.
- Detailed provision relating to tax treatment of leasing need to be introduced.
- Abolish tax holidays, concessions or rebates to specific sector and introduce lower rate across-the-board, liberal deductions system, reasonable depreciation system, including accelerated depreciation sufficiently long period of loss carry forward and taxation on the basis of actual transaction.
- Enter into bilateral agreements with other countries and develop technical capacity on tax treaty matters for the purpose of their implementation at times of need.
- Limit presumptive tax to those incomes where it is extremely difficult to impose normal tax, i.e. very small enterprises, whose turnover is below 24 million Tugriks may be subject to presumptive tax.

- Make some rough adjustments in income taxes through discretionary measures in order to minimize the effect of inflation.
- Adopt an income tax payment system in three or four installments instead of every month.
- Introduce an estimated return to be submitted some time at the end of first half of the year and final return within three months after the expiry of the year, instead of current quarterly and an annual return system.

B2. VAT

- Overall VAT exemptions should be kept minimum. Those items that are extremely difficult to bring into the tax net from an administrative point of view such as financial services should continue to be exempted. Similarly, some goods and services may remain exempt on social grounds. For example, educational services relating to formal education such as school, colleges, or universities courses may remain exempted. Exemptions, including exemptions provided to the imports by foreign investors, tour operators and finance leasing, should be abolished immediately and other exemptions maybe abolished in a phased manner.
- Taxpayers should be allowed to claim a full input tax credit in the case of vehicles purchased for resale or lease. In other cases, they should be allowed to claim 50 percent of tax paid on the purchase/imports of vehicles.
- New registrants should be allowed to claim an input tax credit on stock at the time of registration if the stock was purchased within one year from the date of registration and is supported by proper invoice. They should declare the stock on the day of registration, which if tax administration thinks necessary, can be verified.
- Introduce sufficiently detailed provisions relating to input tax credit in case of mixed transactions. VAT paid on any input that is exclusively used for taxable transaction should be deductible fully. On the other hand, VAT paid on any input that is exclusively used for exempt transactions should not be creditable fully. VAT paid on any input that is used in both taxable and tax exempt sales, should be allowed on a pro-rata basis.
- VAT should not be charged on the sale of a business if the buyer is registered. The latter can be made liable for the payment of tax on such a business. If the buyer is not registered, he should be made liable to register.
- Start-up businesses should be allowed to register even if turnover does not reach to the level of 8 million Tugrigs. Similarly voluntary registration should be permitted to other businesses also. However, tax administration should have full authority to control any bogus registration.
- Streamline refund process. For the purpose of VAT, define any business as an exporter when its exports exceed fifty percent of its total transaction in stead of the existing concept of manufacturer-exporters. Provide a quick refund to the exporters in order to make Mongolian products competitive in the international market. Refund process should be simple. Of course, tax administration must

check those documents that support that the exports have been made and input tax liability was incurred by an exporter.

- In the case of local sales, the excess input tax credit can be adjusted with other tax liability or be carried forward. If the excess credit is not adjusted within 6 months, then taxpayers can claim for refund.
- As refund is one of the core functions of the tax administration, GDNT should be made fully responsible for the processing and approving refunds.
- Develop a brochure/guideline on refund for tax officials, taxpayers and donor community and organize orientation program for the concerned parties to educate them on the refund system.
- Consider introducing a tourist refund scheme in order to promote exports.
- Introduce a longer tax period such as quarterly for the small vendors in order to reduce their compliance cost and also lower the cost of tax collection.
- Abolish the system of annual return. Instead, the tax administration should monitor non-filers and create a computerized assessment for each non-filer during each tax period when the return is not received.

B3. Excises

- Rates of excise duties on vehicles and cigarettes should be increased.
- Introduce excise on domestic beer and consider introducing excises on tire, fur, and expensive electronic appliances.
- Consider converting specific excise duties into ad valorem duties in order to make excise system more elastic, efficient and equitable.

B4. International trade taxes

- Make use of the reference prices only when there are substantial differences (for example more than 20 percent) between the reference price and invoice price. In other cases, where there are reasons to believe for an under valuation, customs administration can select importers for post clearance audit.
- When an importer goes for an appeal to the Customs Head Quarter, goods should be released on the payment of deposit as the security of the customs duties, which can be settled once the decision is made on appeal.
- Exemptions granted on the imports of foreign investors must be abolished.
- Consider adopting an exemption of import of materials to be based in the production of exports, or duty draw back system, or suspension of import duties on the import of inputs to be used in the production of exports, in order to promote exports.
- Export duties on cashmere may be abolished and rates on some items may be lowered.

- Unify customs laws in order to make legal system simple and transparent.

B5. Immovable property tax

- Immovable property tax should cover both commercial and residential properties. It should be levied on the market value and rate should be increased to 1.2 percent from 0.6 percent.

B6. Social security contribution

- Carry out an in-depth study on reforming pension fund and lowering or eliminating social contributions for social insurance, health, unemployment and disability and financing them from general state budget.

B7. Local taxes

- There is a need to gradually develop a sound local fiscal system. Immovable property tax should be developed as the major sources of tax revenue of local governments. This tax should be supplemented by vehicle tax, gun tax, entertainment tax, hoarding board charge etc.

B8. Appeal

- An efficient, effective, and impartial appeal system should be developed. A separate law on appeal may be developed by incorporating existing provisions relating to appeal which are scattered in a number of laws.

B9. Administration

- Tax administration should make every effort to raise the level of voluntary compliance among the taxpayers through the simplification of the tax system, assisting taxpayers in completing their tax formalities, continuous follow up and monitoring and taking stringent actions against tax evaders.
- Conduct training programs for tax officials and tax education for taxpayers. Prepare manuals, brochures and other tax instruction materials.
- Change focus from prepayment of tax to the payment of tax on the basis of actual transaction and increase enforcement activities and penal provisions and their implementation in time of need. Make every attempt to implement all major tax functions such as registration, collection, refund, audit, and investigation.
- Define large taxpayers on the basis of turnover, select sufficient number of large taxpayers in such a way that they generate about 70 percent of total tax revenue and make large taxpayer office responsible only for the administration of large taxpayers.
- Tax administration should take responsibility of enforcing social contributions.
- Strengthen audit capabilities of tax administration.
- Strengthen capability of collecting/enforcing non-tax revenue in an effective manner.

- Introduce cross-reference between tax laws and accounting laws, enforce international accounting standards, and minimize differences between tax and financial reporting system.
- Introduce system of advance ruling.

B10. Tax policy formulation process and long term strategy

- Make tax policy formulation process participatory. A long term tax strategy may be designed. Tax reform measures to be introduced over a period of time need to be approved and published. Tax proposals every year should be prepared as per the long term strategy. The proposals implemented every year must contribute towards the evolution of a good tax system.
- Tax Policy unit need to be strengthened and be made responsible for preparing new tax proposals, analyzing and forecasting revenue and studying the impact of taxation on various aspects of economy.

B11. Legal frame work

Legal reform can be initiated from both short term and long-term perspectives as follows:

Short-term actions

- Gather tax related provisions from different tax and non-tax laws
- Identify duplications and inconsistencies/contradictions in various laws
- Indicate areas where there is a need for clarity
- Indicate provisions that do not follow standard principles/practices
- Prepare guidelines for matters that need to be included in tax laws, tax regulations and ministerial/departmental guidelines or notifications
- Introduce amendments in the existing laws

Long-term Actions

- A comprehensive tax code, regulations, forms, operating manuals, brochures, teaching materials and training need to be developed.
- A law reform task force should be created abovementioned job. This task force should be assisted by expatriate.
- Several training programs for tax officials and a comprehensive tax education program for taxpayers on the new legal system will have to be organized.

C. Epilogue

Our recommendations, if implemented properly, would help reduce the cost of taxation to the economy and make the Mongolian economy more competitive. Reduction in the rate of PIT and lowering the level of social contributions or abolition of social contributions for social insurance, health, unemployment and disability would reduce the cost of labor, which will have a positive impact on the economy. Adoption of a flat CIT rate would eliminate many distortions generated by the existing dual rate system. These measures would also encourage people move from shadow to the formal sector of the economy, which would, *inter alia*, generate higher revenue in the long run. Introduction of more liberal system of deductible expenses and depreciation and introduction of loss carry

forward system would also reduce the cost of doing business and encourage risk taking investment. This would help increase employment opportunities and reduce poverty.

Emphasis on VAT for revenue generation would also generate several positive results in the economy. It is a neutral tax. As VAT does not favor capital against labor or *vice versa*, this tax does not bring unnecessary changes in the production techniques. Similarly, as the total burden of VAT depends on the total final price, not on the proportion of value added generated at different stages, it does not bring unnecessary changes in the channel of distribution. As VAT paid by VAT registrants is either credited or refunded, it does not constitute cost elements of businesses. As a result, there is no need to apply profit margin on the input VAT as it generally happens in the case of all commodity based taxes except retail sales tax. Because of all these reasons VAT produces less cost to the economy than other taxes. This tax also relieves exports from the burden of taxation. Besides, VAT is levied on both imports and domestic products. Further, VAT is paid by nationals as well as foreigners. That is why there is a growing trend around the world to rely more and more on VAT for revenue purpose in both developing and developed world. This is equally important for Mongolia to develop VAT as the main stay of government revenue.

Similarly, expansion in the base and increase in rates of excise duties and immovable property tax would not only generate more revenue but also impose tax on the high income groups who evade income tax in different ways. This would help improve equity in the tax system. While the reduction in rate of income taxes and increase in excise duties and higher reliance on VAT would sound in the outset more regressive, but in practice, it would turn to be a progressive move. This is because income taxes are being avoided/evaded grossly by high income groups. Tax evaded income is basically used either in holding residential property, purchasing cars or in the consumption of imported luxury goods. Effective implementation of VAT, excise and immovable property tax would place higher tax burden on higher income groups than on the poor. Further, introduction of basic allowance under the PIT or increase in the tax credit amount would relieve lower income group from the burden of income tax. Similarly, abolition of some social security contributions also would help relieve lower income groups from the burden of taxation.

Reform of tax administration would help implement tax laws effectively and uniformly across the sectors. It would help improve horizontal equity and reduce distortions. Reform of appeal system and tax policy formulation process would help build confidence of public in the tax system. Increasing tax awareness among the citizen and raising the level of voluntary tax compliance among the taxpayers are not only the ways of generating more revenue but also engaging more and more people in the government affairs, thereby strengthening democracy.

ANNEX A: NATIONAL AND LOCAL TAXES

ANNEX A: NATIONAL AND LOCAL TAXES

National taxes:

- Income tax of business entities and organizations
- Personal income tax
- Customs duties
- Value-added tax
- Excise duties
- Tax on auto fuel and diesel fuel
- Payment for use of mineral resources

Local taxes:

- Gun tax
- City tax
- Dog tax
- Inheritance and gift taxes
- Real estate tax
- State stamp tax
- Payment for use of water and springs
- Tax on auto vehicles and self-moving vehicles
- License fee for use of natural resources, except minerals resources
- Payment for use of natural plants
- Payment for use of widely spread mineral resources
- Payment for use of hunting resources
- Animal hunting and catching license fee
- Land payment
- Payment for procurement and use of wood fuel and timber from forest

ANNEX B: TREND AND COMPOSITION OF REVENUE

ANNEX B: TREND AND COMPOSITION OF REVENUE

	1999	2000	2001	2002	2003
(Tugrigs in Million)					
Tax revenue	181,232.4	260,640.8	328,203.2	359,179.2	404,410.8
Non-tax revenue	66,626.8	85,564.50	101,748.2	110,569.4	121,958.0
Total revenue	247,859.2	346,205.2	429,951.4	469,748.6	526,368.8
Percent of total revenue					
Tax revenue	73.12	75.29	76.33	76.46	76.83
Non-tax revenue	26.88	24.71	23.67	23.54	23.17
Total revenue	100.00	100.00	100.00	100.00	100.00
Percent of GDP					
Tax revenue	19.6	25.6	29.4	28.9	29.7
Non-tax revenue	7.2	8.4	9.1	8.9	8.9
Total revenue	26.8	34.0	38.5	37.9	38.6

Source: Based on data in Appendix Table A2.

ANNEX C: TREND AND COMPOSITION OF TAX REVENUE

ANNEX C: TREND AND COMPOSITION OF TAX REVENUE

Sources	1999	2000	2001	2002	2003
Amount (Tugrugs in Million)					
Income taxes	39,044.3	62,826.1	64,504.5	72,433.9	81,811.8
Social security contributions	29,784.9	39,272.7	53,956.7	54,397.6	63,623.2
Property taxes	299.3	262.9	1,716.9	3,350.4	4,473.0
VAT	60,360.2	76,218.6	104,193.8	118,688.2	121,685.3
Excise duties	26,731.2	41,011.8	53,330.0	51,321.3	58,914.6
Special revenues	6,832.1	7,117.0	8,892.0	8,595.6	9,741.6
International trade taxes	9,013.4	22,305.9	27,018.7	24,592.5	32,653.7
Others (fees and payments)	9,167.0	11,625.6	14,590.5	25,799.7	31,507.6
Total	181,232.4	260,640.8	328,203.2	359,179.2	404,410.8
Percent of total					
Income taxes	21.5	24.1	19.7	20.2	20.2
Social security contributions	16.4	15.1	16.4	15.1	15.7
Property taxes	0.2	0.1	0.5	0.9	1.1
VAT	33.3	29.2	31.7	33.0	30.1
Excise duties	14.7	15.7	16.2	14.3	14.6
Special revenues	3.8	2.7	2.7	2.4	2.4
International trade taxes	5.0	8.6	8.2	6.8	8.1
Others (fees and payments)	5.1	4.5	4.4	7.2	7.8
Total	100.0	100.0	100.0	100.0	100.0

Source: Based on data in Appendix Table A2

ANNEX D: TAX LIABILITY OF BIG/SMALL BUSINESSES

ANNEX D: TAX LIABILITY OF BIG/SMALL BUSINESSES

Tax liability of a big business will be much lower when it is divided into three units than it remains as one business as follows:

(Tugrigs in Million)

Description	Big Business	Business A	Business B	Business C
Purchase	800	267	267	266
Wages and salaries	200	67	67	66
Interest	300	100	100	100
Profit	300	100	100	100
Total sales	1600	534	533	533
VAT				
Input tax	120	40.00	40.00	40.00
output tax	240	80.00	80.00	80.00
Payable VAT	120	40.00	40.00	40.00
CIT				
First 100 @ 15%	15	15	15	15
Rest 200 @ 30%	60	-	-	-
Total	75	15	15	15
Social security tax	38	12.73	12.73	12.54

ANNEX E: TAX INCENTIVES PROVIDED UNDER THE INCOME TAX LAWS

ANNEX E: TAX INCENTIVES PROVIDED UNDER THE INCOME TAX LAWS

Exemptions

- Income from interest on the Government bond;
- Income from donor's blood, and blood products;
- The income of the social insurance and the social care fund;
- The income of Mongol-Bank (the Central Bank);
- The income of state registered non-government organizations that provide social services
- The income, derived from sale of share products by a foreign company, which is carrying out business in Mongolia in accordance with product sharing contract concluded with the Government of Mongolia in oil sector, and its transfer shall be exempt from the taxation

Tax Holidays and rebates

Foreign investment related

- Power and thermal plants and transmission network thereof, highways, railways, airways and engineering constructions, basic network of telecommunications - 10 years of tax exemption and 50 percent tax relief in the subsequent 5 year period;
- Mining and processing of mineral resources, oil and coal, metallurgy, chemical production, machinery, electronics- 5 years of tax exemption and 50 percent tax relief in the subsequent 5 year period;
- If a business entity with foreign investment in other than above-mentioned areas, exports more than 50 percent of its production, it will receive tax exemption for 3 years and 50 percent tax relief in the subsequent 3 year period.

Specific field related

- A business entity, which invests to construction of electricity source and network, and technology renovation, shall enjoy income tax exemption to the extent of the invested amount for 10 years after its establishment and 50 percent tax relief in the subsequent 5 years.

Geographical area related

- Business entities and organizations that are newly established to conduct production and services on the territory of an Aimag, located in a region where conditions for growth of industries and services are being developed, and registered with the Aimag's tax authority shall enjoy corporate income tax exemption in the first year and 50 percent tax relief during the subsequent two years.

- Business entities and organizations, which are newly established to conduct production and services on the territory of an Aimag, located in a region where conditions for growth of industries and services are underdeveloped, and registered with the Aimag's tax authority, shall enjoy corporate income tax exemption in the first year and 75 percent tax relief during the subsequent two years.
- Business entities and organizations that are newly established to conduct production and services on the territory of Soums located at the distance of more than 100 kilometers from the centers of the Aimags, where conditions for growth of industries and services are underdeveloped shall enjoy corporate income tax exemption during the first two years and 50 percent tax relief in the subsequent year.

Tax deductions and other incentives

- If a foreign investor reinvests its income into own entity then the taxable income of the concerned business entity shall be subject to deduction amounting to such reinvestment.
- The economic entities engaged in manufacturing cereals, potato and vegetables are allowed to reduce taxable income of the above-mentioned activities by 50 percent.
- If the business entity uses its own assets for international, national, local road construction and its repair, then these assets is deductible from the total taxable income.

ANNEX F: WORKING OF VAT AND TURNOVER TAX

ANNEX F: WORKING OF VAT AND TURNOVER TAX

While VAT is levied on value added at each stage in the production and distribution roves, value added is never calculated directly but the same result is obtained indirectly though tax credit/refund. Let us suppose an importer imports goods worth of 100 Tugrigs. He pays 5 percent import duties at the customs point and let us suppose this item is not subject to excise duties. For simplicity's sake, let us suppose importer's mark-up on customs inclusive price (i.e. 105) is 20 percent. Let us also assume that wholesaler's and retailer's mark-up percent is the same like that of importer (i.e. 20 percent at each level). Under these assumptions and in the absence of any tax (except import duty), as indicated in column 3 of the following Table, importer's, wholesaler's and retailer's selling prices would be Tugrigs. 126.00, 151.20, and 181.40, respectively. Working of VAT may be seen from Part (a) while the working of turnover type of tax may be seen from part (b) of the following Table.

(a) Working of VAT

SN (1)	Description (2)	VAT exclusive price (3)	Output tax (4)	- (5)	Input tax (6)	Net VAT (7)	VAT inclusive price(8)	Remarks (9)
1	Import	100.00						
2	Import duties	5.00						
3	Total	105.00	15.75	-	0	15.75	120.75	
4	Importer selling price	126.00	18.90	-	15.75	3.15	144.90	
5	Wholesaler selling price	151.20	22.68	-	18.90	3.78	173.88	
6	Retailer selling price	181.40	27.21	-	22.68	4.53	208.61	
7	Tax induced rise in price							27.21
8	Total VAT							27.21
9	7-8							0

As taxpayers can take an input tax credit or get a refund, VAT does not constitute a cost element to the business. As a result, under the VAT, price increases by the amount of tax only. However, it will not be true if tax credit and/or refund are not allowed. In that case VAT will turn into a turnover tax, where tax induced rise in price will be higher than the amount of tax revenue.

(b) Working of turnover type tax

SN (1)	Description (2)	Price at various stages in the absence of tax (3)	Price at various stages under the turnover type tax (4)	Remarks (5)
1	Imports	100.00	100.00	
2	Import duties	5.00	5.00	
3	Total	105.00	105.00	
4	Tax at 15 percent	-	15.75	
5	Grand Total	105.00	120.75	
6	Mark-up	21.00	24.15	
7	Selling price of importer	126.00	144.90	
8	Tax at 15 percent	-	21.73	
7	Cost to wholesaler	126.00	166.63	
8	Mark-up	25.20	33.33	
9	Selling price of wholesaler	151.20	199.96	
10	Tax at 15 percent	-	29.99	
11	Cost to retailer	151.20	229.95	
12	Mark-up	30.20	45.99	
13	Selling price of retailer	181.40	275.94	
14	Tax at 15 percent	-	41.39	
15	Price to final consumer	181.40	317.33	
16	Tax induced rise in price	-		135.90
17	Amount of tax	-		108.86
18	16-17	-		27.04

Tax is levied upon tax under a turnover tax, resulting in tax cascading and pyramiding. As indicated in the above table, tax induced rise in price is higher than the tax amount. As such a tax is very much distortionary; it has been abandoned by almost all countries.

ANNEX G: MECHANISM TO MAKE EXPORT FREE OF IMPORT DUTIES

ANNEX G: MECHANISM TO MAKE EXPORT FREE OF IMPORT DUTIES

Many countries of the world have incorporated the policy of developing the economy by encouraging exports. It is more necessary for the economic development of a country such as Mongolia where the market is very small. For this purpose, a policy to attract internal and foreign investments must be incorporated and this must be effectively implemented. In this context, tax system and tax administration must be used in such a way that it encourages the export sector. Export cannot flourish and investment cannot be attracted if tax is imposed on products imported or purchased for the use of export products and if the system of returning the amount is costly.

In order to encourage export, such measures as duty exemption, lower duty rate, bank guarantee, passbook, export processing zones, bonded warehouse and duty drawback can be adopted.

A. Duty exemption

It is appropriate to exempt customs duty of those products which are imported only for the production of export products. Similarly, the raw materials, supplementary raw materials and other materials used for the production of goods of which 90 percent of the gross production is exported must be tax exempt. But, there are limited numbers of materials which are only used for export products. Most of the materials are used for export products as well as products to be sold in the local market. Therefore, the system of tax exempt on materials which are totally used for export products has limited use.

B. Lower duty rate

At times, materials imported by exporters for the production of export products can be taxed at a lower rate than the prevailing rate. But, under this system, it cannot be clearly stated which products are used for export products. Taking this advantage, some of the people use the imported goods or materials at lower imports tariff for producing products for local sale. It is difficult to control such misuse in an economy such as Mongolia where the informal sector is very big. Therefore, the possibility of implementing lowered tax rate is very limited similar to tax exempt. Further, rate of import duty is already low in Mongolia.

C. Suspension of duty

There is a practice to suspend customs duties on the imports of materials for the production of exports. The customs administration keeps an account of the type of material which is adjusted after the product is produced and exported.

For the security of revenue, the exporter has to buy government bond or some government accepted security bond equivalent to the amount to be paid as customs duty. Under this system, the possibility of revenue loss will be nil and exporters will get an interest from the investment made in the bond. The system of bank guarantee can also be used as an option for bonds. The benefit of cash flow can be obtained from bank guarantee since the exporter will not have to invest in bank guarantee but only has to pay a certain charge to the bank for staying guarantee whereas the exporter has to make certain investment for buying bonds. The other option can be the deposit of equivalent amount in interest account of a bank. Under this system, the exporter can withdraw the amount through the recommendation of customs officials after the product has been exported. The system of tax exemption can be implemented through passbook, export processing zones or bonded warehouse.

C1. Passbook system

Under this system, the customs duties imposed for the imported materials required for the production or processing of export product is kept as guarantee and the statement is mentioned in the passbook provided to the exporters. Verification of the amount to be imposed for the imported goods is done after the finished products are exported. In order to make export tax free, exporters must have the facility to adjust the tax in all materials.

C2. Export processing zones

Under the export processing zone (EPZ), an industry is established for the production or processing of fully export products. Such industries are established near a harbor or international transport point. No tax is imposed on imported or purchased raw materials, supplementary raw materials, chemicals, fuel, packaging materials, machinery, equipment, etc., for industries established in such sectors. If the industries established in EPZ sell the products in the local market, the customs duties exempt at the point of import will be collected.

Since no tax is imposed on the materials imported for EPZ and there is no interference by the employees, these sectors are very supportive for export processing. It also holds special importance in attracting foreign investment since foreign investors do not have to come in contact with the local tax administration.

But, most of the countries have not been able to use this since it is very expensive to develop such sectors and to shift already established industries to the sector.

C3. Bonded warehouse

The system of bonded warehouse is also implemented to encourage export. Under this system, the industries of the export country do not need to be established in a specific sector in order to get tax facilities on import or purchase.

Under this system, tax exemption is given on raw materials, supplementary raw materials and the import or purchase of other items but tax is imposed on machinery equipment. If the imported materials are sold in the local market, customs duties will be imposed on raw materials, etc., as well. In order to manage this system, proper accounting of semi-finished and finished materials must be maintained and there should be a system of taking strong actions against those who misuse this facility.

Some conditions are also imposed in the system in order to make it easy for real exporters to use the facility and to discourage the misuse of this facility. For example, this facility is given to exporters who produce goods only for export or to individuals who export more than a certain percentage of the gross transactions or to individuals who export more than a fixed amount.

However, the system of suspending import duties at the customs point is not as simple as straight exemption of import duties. It is very difficult to estimate the customs duties since some of the imported or purchased materials are used for export products and some are not. Similarly, machinery and equipment may be used for a long time in future and it cannot be determined whether they will be exported in future. The imported raw materials may also be used for the production of goods inside the country and the same goods may again be used for producing or processing export products. In many cases, the imported materials without paying customs duties or the product made through such materials are sold in the local market and these are not taxed. Effective monitoring is required in order to curb this kind of misuse of the system.

C4. Duty draws back

Under this system, exporters get back the customs duty paid while importing raw materials, supplementary raw materials, chemicals, machinery, equipment, fuel, packaging materials, etc., on the basis of export. However, much accounting is required to estimate the customs duty imposed on exported goods. In some countries tax is returned on the basis of input-output coefficient and in others an average rate is maintained for administrative simplicity. The system of maintaining an average rate results in unequal distribution since the exporters will not get the return on the basis of the duty paid and some will get a higher amount and some less.

In order to make duty draw back system more effective, tax inspection of the firm's accounts and records must be done and proper information of the technical aspect of the production process is required. But, this system has not been effective in developing countries because they lack both the above factors. Moreover, the employees ask for bribes. Furthermore, customs officials do not want to refund the amount because any refund would lower the collection of customs revenue. In order to avoid this in some countries, the amount to be returned is given as expenditure through budget sanction. But, under this system the process of returning the amount after export will be complex and all the exporters will not get the amount because of limited budget allocation.

In some countries a separate body for tax refund has been formed. But, the experience is not that positive. Such units generally lack the required information of the taxpayers transactions, lack experienced and capable employees to detect tax defaulters, lack employees having knowledge of fiscal aspects, employees are more attuned towards promoting export rather than preserving revenue, non-sensitivity regarding revenue and the units are closed after a big corruption incident.

**ANNEX H: GROSS DOMESTIC PRODUCT BY INDUSTRIES (TUGRIGS IN
MILLION)**

ANNEX H: GROSS DOMESTIC PRODUCT BY INDUSTRIES (TUGRIGS IN MILLION)

#	Industries	1999	2000	2001	2002	2003
	Total	925 345.8	1,018,885.7	1,115,641.4	1,240,786.8	1,362,526.6
1	Agriculture, hunting and forestry	342 127.6	296,484.9	277,561.0	256,623.5	272,852.1
2	Mining & quarrying	79 780.0	117,161.0	100,832.0	125,896.3	129,043.7
3	Manufacturing	54 970.8	62,507.3	90,144.3	77,974.9	81,561.7
4	Electricity, gas & water supply	33 711.1	24,631.7	32,955.3	46,812.1	48,637.7
5	Construction	22 984.1	19,310.8	21,931.9	29,013.7	33,365.8
6	Wholesale& retail trade; repair of motor vehicle., motorcycle & personal & HH goods	191 672.1	244,583.5	297,831.9	344,010.5	391,881.0
7	Hotels & restaurants	12 315.3	13,584.9	14,259.3	15,413.4	16,646.5
8	Transport, storage and communication	84 690.5	112,195.8	144,941.2	182,765.1	205,869.2
9	Financial intermediation	20 620.7	25,414.0	35,069.0	39,510.8	46,783.0
10	Real estate, renting & other business activities	9 368.3	10,351.4	11,428.5	14,717.5	16,590.0
11	Public administration& defense; compulsory social security	33 621.7	47,064.0	48,179.5	55,959.4	62,423.5
12	Education	34 076.3	46,960.8	50,060.8	57,323.0	63,838.9
13	Health & social work	19 156.2	19,233.9	20,639.4	22,559.2	25,011.9
14	Other community, social & personal service activities	2 750.0	4,244.0	4,931.6	7,697.9	8,547.5
15	FISIM	-16 499.0	-24,842.2	-35,124.3	-35,490.5	-40,526.0

Source: Mongolian Statistical Yearbook 2003. Ulaanbaatar 2004.

ANNEX I: DETAILED BREAKDOWNS OF REVENUE (TUGRIGS IN MILLION)

ANNEX I: DETAILED BREAKDOWNS OF REVENUE (TUGRIGS IN MILLION)

Industries	1999	2000	2001	2002	2003
Total revenue	247,859.2	346,205.2	429,951.4	469,748.6	526,368.8
Tax revenue	181,232.4	260,640.8	328,203.2	359,179.2	404,410.8
Income tax	39,044.3	62,826.1	64,504.5	72,433.9	81,811.8
Personal income tax	12,593.4	14,830.0	20,675.8	26,165.1	29,081.9
Corporate income	26,450.9	47,996.1	43,828.7	46,268.8	52,729.9
Social security contributions	29,784.9	39,272.7	53,956.7	54,397.6	63,623.2
social insurance	23,398.7	30,059.4	41,427.7	41,882.6	0.0
Health insurance	6,386.2	9,213.3	12,528.9	12,515.0	0.0
Property tax	299.3	262.9	1,716.9	3,350.4	4,473.0
immoveable property tax	182.4	150.5	1,593.0	3,225.1	0.0
gun tax	116.9	112.4	124.0	125.3	0.0
Domestic trade taxes	93,923.5	124,347.4	166,415.9	178,605.1	190,341.5
VAT	60,360.2	76,218.6	104,193.8	118,688.2	121,685.3
Domestic goods	28,941.6	30,182.1	43,798.3	40,696.0	47,821.5
Imported goods	31,418.6	46,036.5	60,395.5	77,992.2	94,251.4
VAT refund		0.0	0.0	0.0	-20,387.6
Excise tax	26,731.2	41,011.8	53,330.0	51,321.3	58,914.6
Domestic vodka	11,159.2	15,891.7	23,187.9	20,399.2	18,856.0
Imported vodka & cigarettes	3,698.6	4,470.0	3,065.0	3,543.0	3,678.8
Imported beer		0.0	3,118.9	2,888.6	3,307.2
Car	3,054.0	7,245.3	7,332.0	6,028.2	10,549.6
fuel and diesel	8,819.4	13,404.9	16,626.2	18,266.3	21,254.1
Domestic cigarettes		0.0	0.0	196.0	1,268.9
Special revenues	6,832.1	7,117.0	8,892.0	8,595.6	9,741.6
auto fuel and diesel tax	4,316.8	4,189.3	5,454.5	4,850.3	5,703.1
Transport facilities and vehicles tax	2,515.3	2,927.7	3,437.5	3,745.3	4,038.5
International Trade taxes	9,013.4	22,305.9	27,018.7	24,592.5	32,653.7
Import duties	5,852.0	17,152.9	25,991.4	23,767.3	31,065.6
Export tax	3,161.4	5,153.1	1,027.3	825.2	1,588.1
Other (fees and payments)	9,167.0	11,625.6	14,590.5	25,799.7	31,507.6
state stamp fee	2,335.3	2,787.2	3,126.5	5,147.1	7,293.1
Loyalty	3,173.4	3,488.2	3,743.0	10,972.8	11,667.4
land fee	1,945.8	3,374.0	4,982.0	6,077.2	8,386.1
Payment for procurement and use of wood fuel and timber from forest	271.7	485.5	582.0	574.3	629.9
Payment for use of hunting resources, animal hunting and catching license fee	924.5	958.8	1,581.6	2,154.6	2,620.8
License fee for use of natural resources, except min. res.	37.3	43.4	17.0	41.1	0.0
Payment for use of natural plants	195.9	263.8	275.4	506.0	0.0
Payment for use of water and springs	177.9	192.8	205.0	234.8	0.0
Payment for use of widely spread mineral resources	104.8	31.8	78.0	91.7	0.0
Dog payment in urban areas	0.4	0.1	0.0	0.0	0.0
Non-tax revenues	66,626.8	85,564.5	101,748.2	110,569.4	121,958.0
Dividend	5,690.4	17,189.8	19,865.8	6,402.6	1,938.3
income earned by budgetary organizations	32,070.0	35,184.5	47,169.7	47,953.6	65,989.9
other income	8,454.3	8,634.1	5,949.3	15,732.9	6,219.8
interest and fine income	3,510.4	8,135.0	7,984.4	9,062.0	17,035.9
income from rent	6,401.7	6,309.6	8,438.3	9,364.9	10,232.5
oil income	500.0	500.0	450.9	599.3	0.0
navigation income	10,000.0	9,611.5	10,389.8	12,500.0	12,113.7
Central Bank's profit	0.0	0.0	1,500.0	8,954.2	8,427.9

Source: Ministry of Finance and Economy.

ANNEX J: GIST OF THE OPINION OF THE PERSONS INTERVIEWED

ANNEX J: GIST OF THE OPINION OF THE PERSONS INTERVIEWED

July 26, 2004

Arrival and Meeting with the following project staff. Discussion on the activities to be carried out during this visit.

Dr. Janusz Szyrmer, Senior Policy Advisor, EPRC
Mr. Christopher Broxholme, Deputy Chief of Party and Trade Lawyer, EPRC
Mr. Munkhsaikh Dambiinyam, Accounting Specialist, EPRC
Ms. Doljinsuren Jambal, Economic Analysis, EPRC
Ms. Uurtsaikh Sanghi, Operations Manager, EPRC
Ms. Minjin Oyuntsetseg, Resource Centre Officer, EPRC
Ms. Bolor Purevdorj, Translator/Interpreter, EPRC

July 27, 2004

Discussion on the outline of the report, with Dr. Janusz Szyrmer, Senior Policy Advisor, EPRC.

July 28, 2004

Mr. Erdenbaatar Baljinnyam, Head of the Tax Administration and Methodology Division, General Department of National Taxation

Mr. Baljinnyam provided a detailed account on the existing organizational structure of the tax administration, personnel system, relation between tax administration and the Ministry of Finance, and working of the tax administration.

Mr. Horst Meinecke, Senior Energy Advisor and Mr. Amgalan Nordov, Energy Specialist, EPRC

Imports by foreign investors are free from import duties. There are some tax holidays. Mongolia has adopted International Accounting Standard (IAS); they have not been updated in line with the changes introduced in the IAS. Rather these standards have been distorted by government regulations. Tax system is not investor friendly.

Mrs. Dawn E. Rehm, Resident representative, IMF, Mongolia.

Tax laws exist, but very short. Tax system is very much discretionary. Fund is going to work on tax legislation. Local government finance is poor. At this stage, local governments simply do not have capacity to implement any thing in a proper way. So fiscal decentralization is just impossible at this stage. Mongolian economy faces many problems which are not easy to fix.

Mrs. S. Gerelmaa, Director of state organization's law and regulation sector, National Legal Centre

Legal centre conducts training for lawyers and judges, conduct research and disseminates information. It compiles all changes in tax laws, regulations or circulars and publishes them in its monthly bulletin.

It is going to conduct a research on the tax appeal system soon. She provided a brief account of appeal and law formulation process and pointed out the implementation problem of taxation, including VAT, where the credit system has not been working properly.

July 29, 2004

Mrs. Baasankhuu, General Director of Budget Department and Mrs. Ganchimeg P., Ministry of Finance and Economy

The tax system itself is new and changing. So it is difficult to know about it even by tax officials. Attempts are being made to educate taxpayers through tax centers. Need to adopt a unified corporate rate have been realized and efforts are being made to this direction. But it is not possible to do at one shot because of huge revenue implication. It needs to be implemented perhaps in a phased manner. Tax reform needs to be implemented in phased manner.

July 30, 2004

Mr. Stephen D. Vance, Executive Director, Mongolian Foundation for Open Society (Soros Foundation)

Basic tax laws are in place, but the information is not disseminated, even the tax officials do not understand the laws properly and the implementation is very poor. Taxation is not the main hindrance for attracting foreign investment. There is a provision for tax holiday for certain industries.

NGOs are required to submit annual plan of activities and Balance Sheets each year to the Ministry of Justice, but not complied by almost 99 percent partly because they do not know and partly they do not want to. About 4,000 NGOs are registered. Some businesses have been registered as NGO to avoid tax formalities.

There is a need to change behavior of the government officials, who do not adopt participatory approach in formulating new tax changes, do not educate taxpayers and civil society, and corruption exists at all levels in different scale. Arbitrary decisions are made at all levels.

Soros foundation prepared a proposal for the civil education, where tax education has been included in the school curriculum. It was accepted by the Ministry of Education and implemented.

Mr. Barry J. Hitchcock, Country Director and Resident Representative, Asian Development Bank

Mongolia collects higher taxes from a limited number of taxpayers than many other developing countries. It is timely to develop tax reform package that will encourage development. While it is necessary to keep customs at a low uniform rate, as it is now, differential corporate tax rates for small and large companies is certainly not a good idea. ADB would be interested in tax issues related to capital market, such as taxation of banking, financial companies and insurance business. Overall tax system should be more specific/transparent and less discretionary. Current system of deductible expenses seems to be complex and less clear. There are problems with tax code. There is a lack of transparency in the process of policy formulation. It will be useful to analyze tax issues and come up with

recommendations. They should be first discussed within the government and donor community and consensus needs to be developed. Then it should be discussed with a wider circle, it is also important to encourage local people to advocate for the tax reform. It will be sustainable.

August 2, 2004

Ms. Setsuko Matsumoto, Project Formulation Advisor, JICA

JICA has been supporting public sector, including local governments, cooperatives and NGOs but not the private sector. There is no capacity to use money properly at the local level. So the budget has been centralized very much. It is necessary to strengthen their capacity first. That is why JICA has been organizing training programs to enhance the capacity of tax officials through its “JICA Study Team, The Study on Establishment of Tax Education System”. State does not have enough resources. So they will have to collect taxes. They should collect more tax from big companies, which have been avoiding tax by splitting into several small units. There is a need to bring down the rate of corporate tax in order to stop the practice of splitting big companies into small companies. As import duties are low domestic flours cannot compete with cheap imported flours.

August 3, 2004

Mr. Doyoddorj Baldandorj, Director, Customs Revenue Division

Mongolia joined WTO in 1997 and have completed all requirements and submitted the report (which is required to be submitted once in six years) in 2004. While under WTO agreement, tariff could go up to 30 percent (tariff for tobacco products and alcoholic beverages even up to 50 percent), Mongolian government has agreed with IMF to have a 5 percent tariff on most of the imports. Accordingly, import tariff is fixed at 5 percent on all imports, except 15 percent on certain vegetable and flours during certain period of the year. Mongolia has adopted a GATT valuation system. Under valuation has been a problem, including on imported second hand vehicles. Customs inspectors may use reference prices, but if an importer does not agree with the price fixed by customs inspector, he can appeal to Mongolian Customs General Administration. But if dispute arises, goods cannot be taken out of the customs until the dispute is settled. Customs is automated; as ASYCUDA system did not work well, customs administration has developed its own Automation Information System of Customs which has been running reasonably well since last two years. On the request of the importers, import duties can be collected at importer's premises. Customs also has set up a customs development fund.

Mr. Khurenbaatar, National Senior Expert, Tacis (Technical Assistance to Common Wealth Independent States)

Tacis has been working in Mongolia since 1994. It has so far implemented about 100 projects, small and big in different areas except mining. Their projects are mostly in the field of agriculture (cropping and livestock), higher education and NGOs. From 2004, EU support to Mongolia would come under Asia and Latin America (ALA) Program instead of Tacis. ALAP will support following two projects:

- Support of Export of Agricultural Project, mainly meat
- Co-financing with the World Bank Project on Poverty Reduction Support Credit

As there is an agreement between EU and the Mongolian government to exempt grant money, Tacis projects do not face any tax problems. While there was confusion initially regarding the import duties and VAT on the import of the Tacis project, it was sorted out soon. Tacis writes a letter to the customs administration regarding the importation of the Tacis's project, which are then allowed without payment of import duties and VAT.

Mr. Massound Hedeshi, Partnership and UN Coordination, United Nations in Mongolia

Revenue generation is important for Mongolia from a long-term perspective. This is the fifth largest aid receiving country (per head aid US\$ 100 in stead of US\$ 9 world average). There is a large informal sector. Taxation has not been able to penetrate large part of the private sector. Taxes are high. Tax education is virtually nil. Common people do not know about taxation. The exiting system really has not been conducive for genuine investment and improve compliance. It would be necessary to reduce the level of tax, simplify procedures, educate taxpayers on taxation, and bring them into the tax net, which will ultimately help promote democracy also.

Mongolian tax system has been highly centralized. Provinces do not have any power. They can not respond to local demand. They are in a position to implement some taxes.

August 4, 2004

Mr. James B. Dwyer, North American-Mongolian Business Society.

Members of the North American-Mongolian Business Society are planning to create a working group to work on tax issues. They will lobby for the good tax policy. Taxation system is not transparent and many do not know about it. Perhaps many may not be paying tax. It will be good to ask companies to submit consolidated income tax statement.

Mr. S. Otgonbat, Vice Chairman, Government of Mongolia, Foreign Investment And Foreign Trade Agency

Tax system has been reformed considerably in the recent years. Tax laws are competitive. However, tax officials have not been able to implement them properly. Level of tax education is very low. Income tax rates are at the level of Mongolia's competitors. VAT rate is rather high. VAT credit and refund system has not been working well. Taxation is not a big hindrance to attract foreign investment. It is the lack of information about Mongolia to foreign investors. There should be an equal treatment of domestic and foreign investments. Tax is a sensitive area so should not be changed frequently.

August 5, 2004

Mr. Gereltuya Orsoo, Office Manager, European Bank for Reconstruction and Development, Mongolia Cooperation Fund

Belgium, Netherlands, Luxembourg, Japan and Taiwan have set up Mongolian Cooperation Fund, which has been running projects in different fields including civil aviation, Airlines, private sector banks, privatization of state owned Mongolian Telecom, Mongolian Agricultural Bank, and improving corporate governance. Tax laws are fine but regulations complicate matters and their implementation is very bad. For example, Mongolian Airline Company (MIAT) did not get refund from 1999 to 2003. The company had to put up this issue to the standing committee of the Parliament and Finance Minister several time during the SARS crisis then finally the refund was made in several installments. Tax officials ask for

advance payment. Similarly State Property Committee also demands advance for their dividends. There is also an issue relating to tax treatment of lease of air cart from aboard. Similarly there is no clarity regarding VAT on rent. Business expenses are not fully deductible. Some projects are included in the VAT exempt list while others not. There is a discretionary power in this matter.

Mr. Chuluunbat Nergui, Head of Economic and Business Analysis Centre, Mongolian National Chamber of Commerce and Industry

Chamber carries out researches and analysis also in the field of taxation. In April 2004 Chamber organized a national level conference where tax issues were discussed widely. As a result of the conference a working group consisting of both government and private sector representative has been formed. This committee has already prepared a mid-term working plan. Tax measures to enhance economic growth have been discussed. Main taxation issues at this stage are: level of tax is very high, which is paid by a few big companies. Many businesses are not in the tax net and those who are in the tax net also maintain two sets of account, one for tax purpose and the other for their business purpose. About 50 to 60 companies pay about 60 to 70 percent of total tax revenue. There is, therefore, a need to reduce the income tax rate around 20 percent, corporate tax should be levied with a flat rate while personal income tax with progressive rates. Tax collection mechanism must be improved. And, taxpayers as well as tax officials should be educated on tax system and tax procedures.

Mr. Bruce Harris, Competitiveness Specialist, EPRC

Tax system is not transparent. We hear different things from different persons. Businesses complain that not all their business expenses are deductible. Tax officials disallow certain expenses relating to marketing, advertisement, human resource development and so on. This is not good for the promotion of business. Tour operators are exempt from VAT, but not others who may be doing similar business. It may lead to interpretation and corruption. There is no incentive for the exempt businesses to ask for an invoice. It may create loop hole in the system and support underground economy. It will be useful to identify the types of legal entities and their tax treatment.

August 6, 2004

Mr. D. Bailikhuu, Advisor, Government of Mongolia State Property Committee

Mongolian tax system does not promote business. Tax level is too high. As a result, companies keep two sets of accounts in order to avoid or reduce tax liability, they prefer cash transactions rather than banking transaction, they hire tax consultants to prepare two sets of account and there is a tendency among the companies to split their business to lower the tax at a time when there is a trend to merge companies in other countries. The existing system encourages corruption in the tax and customs administrations. Due also to the existing tax system, it has been difficult to implement corporate governance program properly.

The existing system simply does not take into account the reality. Mongolia's market is small but costs are high. But on the other hand, of the two neighbors, Russia is not safe because of Mafia and China has a very controlled regime. Mongolia is one of the safest countries in the world. If it adopts liberal rules and lowers taxes, there is a possibility to attract foreign investment.

Tax policies are formulated by a small group of bureaucrats working in the Ministry of Finance and tax administration. Other stakeholders, including business community, academia etc. are not consulted.

Some politicians, academicians, professionals are considering to set up an informal working group to lobby for a sound tax policy.

August 10, 2004

Mrs. L. Badamkhand, CPA, Manager, International Cooperation, Mongolian Institute of Certified Public Accountants

Accounting law was introduced in Mongolia in 1993 which was amended in 2002. According to this law businesses are required to produce financial statement according to International Accounting Standard (IAS). However, no training has been provided to accountants and tax officers on this accounting system. Tax officers do not accept accounts maintained in this format. They insist businesses to follow tax rules. For example, businesses are required to adopt straight-line method of depreciation; they can not choose other methods. This leads to dispute between tax officials and taxpayers. There is a need to develop detailed guidelines and train both tax officials and taxpayers.

Accounting council is responsible for conducting CPA examination, granting titles and providing certificates to the successful candidates. Mongolian Institute of Certified Public Accountants is responsible for providing training for CPA and upgrading and updating their knowledge. There is also an Association of Mongolian Auditors, which is not active.

Mr. Shin Jae Chun, President and Mr. Kim Seung Soo, Director, Seoul Construction Co. Ltd.

Taxation is not a big problem for businesses in Mongolia. It is better to do business in Mongolia than in Japan or China because there are many tax incentives, government has been supporting foreign investors and labor is cheap. So they have been working successfully in the construction business since five/six years in Mongolia.

Mr. Tamir, Deputy Director General of Industrial Policy and Coordination Department, Ministry of Trade and Industry

For certain sector these are tax holidays and other incentives. But they are not working well. For example, private sector is not interested to invest in power and infrastructure. Further, while there are some tax incentives for rural areas, it has not been easy to define such areas. Technology equipment imported by foreign investors are exempt as well. There is no system of duty draw back. There is a system to submit plan for the next year, indicating revenue, expense, net income and tax to be paid. This plan is to be submitted to Soum inspector, who submits it to Aimag; Aimag in turn submits it to GDNT and GDNT to the Ministry of Finance. On the basis of this, Ministry of Finance prepare budget for the next year and presents it to the parliament. Tax inspectors try to collect tax from each company on the monthly basis according to the plan submitted by the company. Since the bonus of tax officials depend upon the fulfillment of revenue collection according to plan, they will make every effort to collect revenue, irrespective of financial situation of a company. In 2002, USAID organized a training program on tax policy and tax administration for tax officials.

Mr. Mend-Amar. L, Treasury Manager, Financial Department, MIAT, Mongolian Airlines

MIAT has leased air bus (financial lease) from May 1998 and leased Boeing (operating lease) from July 2002. There is a system to pay 20 percent final withholding tax on lease since 2001. But as it was not mentioned in the lease contract relating to air bus, the lesser do not agree to pay this 20 percent tax. Consequently, MIAT has been paying this tax. The company has to pay income tax as per the plan submitted one year before. If there is a loss at the end of the year, it does not get refund that has to be just carried forward. Loss has to be paid through bank loans and tax administration does not pay the interest. So company faces financial problems.

MIAT does not get VAT invoice when it buys fuel from the Civil Aviation Authority offices located in each Aimag. The price is VAT inclusive price, but MIAT can not complain an input tax credit. In case of catering, it buys without VAT since they are treated as exports. Similarly, MIAT has a contract with a private company to buy fuel for international flight free of VAT. There are two prices: one for international flight and the other for domestic flights, latter inclusive of VAT

August 11, 2004

Mr. Brendan Donohoe, Managing Director, MIAT, Mongolian Airlines

Import duties and excises have been imposed on the import of spare parts to be used in both domestic and international flights. Where is the boarder? There is a conceptual problem. Withholding tax of 20 percent is imposed on the total lease amount paid to lesser.

Companies are required to submit to the local tax office the budget for the next year by August this year. They are not detail. Board of companies just compare this budget figure with last year's figure. But it has to be surplus. Deficit budget cannot be accepted. While these are very rough estimates, companies are required to pay income tax on the basis of these figures. Part of the problem is law itself; even bigger problem is the interpretation. State-owned companies do not protest the interpretation of the tax officials. Still major problem lies with companies, which can not fire their employees on the ground of inefficiency, misconduct, discipline. For example, MIAT fired some staff. Most of them went to the court and won the case, so reinstated.

August 12, 2004

Mr. Baldan Ganhuleg, Senior Official, General Department of National Taxation

There has been continuous effort to upgrade tax laws. Recently, arm's length principle and thin capitalization rules have been incorporated into the tax laws. But it is very difficult to implant them. E-commerce also has been emerging as a difficult area.

Taxpayers' compliance level was high until the mid-1990s but since then particularly large companies have been using tax consultants to explore loopholes in the tax laws and find out ways to evade tax. There is a dispute settlement committee at the district and central level to hear complains from the taxpayers about tax officer's decision. Taxpayers can even go to court if they are not satisfied with the decision of the national tax administration. But taxpayers prefer it to be settled at the tax administration since it is cheaper and not time consuming.

Ms. Shagdarsuren Nurmaa, General Manager, Normin Holding

Overall tax system is not business friendly. Tax system induces business to split. Many businesses managed by the same group of people have been divided into different units to avoid paying 40 (now 30%) CIT. As checks are more frequent to big companies than small companies, it also encourages splitting companies.

Most of the employees are young 24 or 25 years. They do not want to pay tax in general and social security in particular. In the case of employees whom the company does not want to lose, social securities and tax are borne by the companies. Particularly as pension depends on any consecutive five years salary, but not upon the amount of social security paid by the employees, there is a tendency among the young peoples not to pay it.

Tax rules relating to financial sector are not that clear. Taxpayers in the banking and financial sector have to prepare two types of statement: one is financial statement on the basis of the guidelines developed by the bank of Mongolia (Central Bank) and other as per the tax rules. They have two sets of accounting software one for central bank purpose and other for tax purposes.

Customs valuation is a big problems Customs official raise values even when goods imported from the manufactures. It is difficult to get VAT refund also

Tax officials check financial status of large companies, at least once a year and small companies once in two years. Tax official visit separately for the purpose of various taxes, meaning that some companies may expect several visits of tax offices in a year. But now things are getting better. Three four tax officers visit taxpayers in connection with three four taxes at one time. Tax administration has improved substantially in the recent year compared to mid-1990s or so.

Mr. Ider, Financial Controller of Cashmere Company

Dual rates of company tax are restricting the expansion of the company. Still the upper rate is double of the lower rate. So the rate needs to be reduced from 30 percent. There is a lack of long-term strategy since attempts are being made how to generate revenue within 4 years term of the government. This company has business transaction with 20 companies but as not all are registered under the VAT it is a problem to deal with non-VAT registrants.

Mr. B. Osorgarav, General Director, Ulaanbaatar Audit Corporation Co. Ltd.

Tax burden is high particularly on small and medium businesses. So the lower rate of CIT should not be increased from the current level of 15 percent. The existing audit is weak. Not all companies are required to have their financial statement audited from the audit firms. So many companies do not get their accounts audited. They manipulate their accounts to pay less tax. Tax administration does not have enough capacity to carry out tax audit. So it is necessary to make provision for the compulsory audit of account by auditors for tax purpose.

August 16, 2004

Mrs. Chimed, Chief of Large Taxpayer Office,

LTO is created in 2001 to deal with the large taxpayers. But its scope of work was extended further in 2002. In addition to larger taxpayers, this office also deals with the collection of CIT, PIT, VAT, Excises, and withholding taxes, relating to all taxpayers through local tax

offices. It also deals with all kinds of refunds (refunds to taxpayers, foreign aided projects and diplomats). LTO also carries out audits and supervisions.

August 17, 2004

Dr. Fernando Bertoli, Chief of Party, EPRC

It is good to adopt a bottom-up approach. We should analyze the effect of taxation on various sectors. For this, it is necessary to collect first up to date information on various aspects of tax system and tax procedures. We should examine tax procedures, assess their effect, prepare matrix, identify four or five the most important achievable areas first and advocate for their implementation. Prepare plan of activities. Find out priorities of users.

Mr. Bayasgalan Danzandorj, President and CEO of Golomt Bank, and Mr. Luvsanvandan Boldhjuyag President and CEO of Bodi Insurance Co. Ltd.

Tax system should be more competitive compared to China and Russia, tax laws should be simple and collection procedures transparent. Current tax system is not fair. Some companies with large income pay nominal flat tax where as other companies with lower income pay high tax. Taxpayers need to be educated on tax matters. Due to the lack of knowledge, even banks some time pay more and some times less tax, and pay penalties. Banks are forced to keep two types of accounts: one as per IAS and other according to the tax rules.

It is common to maintain two sets of accounts by the companies: one for tax purpose and one for the business purpose. In theory, tax liability should be guided by the balance sheet and accounts, but here first companies decide how much to pay and then prepare accounts. But gradually companies have been realizing that they benefits from the true balance sheet and accounts. Generally big companies keep real accounts. Now it is time to focus on medium companies and then on small companies.

August 18, 2004

Mr. Larry Jensen, Certified Public Accountant and Short term consultant to EPRC

Mongolia adopted IAS by promulgation of law in 1993, revised in late 1999 and updated in 2002. Mongolian accounting standards have not been keeping pace with that of IAS. IAS are followed by only about 30 percent companies according to a Ministry of Finance Survey. Tax inspectors are not trained on IAS. International Financial Reporting standard have been developed. There are 5 new standard, IFRS also includes the earlier standards.

Mr. Ganhuleg Baldan, Senior Official, General Department of National Taxation Mongolia

As there has been a need to refund huge amount of VAT to the gold mines, gold sale was exempt in order to avoid the refund problem. VAT registrants have to print their invoices from the government approved printing house, which keeps the record of all invoices that may be used by tax administration whenever there is a need. As there is lack of administrative capacity to manage tax at the local level tax administration is centralized at this stage. Local bodes will be given an autonomy when they develop their capacity. Tax is withheld on some purchases in order to impose at least some tax, which is difficult to tax in a normal way.

August 23, 2004

Mr. Jeff Goodson, Senior USAID Program Manager

It will be useful to consider some tax policy measure that could be doable during the forthcoming honeymoon period. Similarly, it will be necessary to consider other issues that need to be implemented over a period of time. Tax reform measures should be divided into three groups viz; Short –term measures, Mid-term measures and Longer-term measures.

Ms. D. Sukhgerel, Development Assistance Specialist, USAID

Government has made several commitments, including the child support, which will need more revenue. Tax reform must be seen in this context. Government's willingness and commitment will be necessary in order to go for a comprehensive tax reform program.

Mr. Saha Dhevan Meyanathan, Country Manager and Resident Representative, the World Bank

The World Bank has been carrying out an investment climate survey, which is expected to be completed within two months. Then analysis etc. will be done. There are different working groups in different fields and a working group on private sector development will be formed soon. Better donor coordination is required.

August 27, 2004

Dr. Sanjaasurengin OYUN, Deputy Speaker of the Parliament

There are many areas that need reform. It is necessary to identify the right size of the state. It will be necessary to identify what should be done by the state and what not. It will also be necessary to introduce budget disciplinary measures, carry out civil service reform and introduce various measures to develop local economy. How long the national government can subsidize the local areas?

August 30, 2004

Mr. Ganbold D., Economic Policy Advisor to the Prime Minister and former non-Portfolio Minister and Chair of Economic Policy of Standing Committee of the Parliament

It is not easy to carryout economic and political reforms together. Recent parliamentary election results are surprising and there is a lack of provisions in the constitution or in the law to handle such a situation. It is a difficult situation to take care or compromise the election manifesto of both parties. However, both parties have made commitment to reduce taxes, to increase social welfare etc. Tax reform measures will be introduced. While many things have been done in the past, they may not be perfect due to social, psychological reasons etc.

Mr. Tsagaan P., Finance and Monetary Policy Advisor to the Prime Minister and Former Minister of Finance

The government will make use of EPRC project and would welcome any innovative ideas, critiques or even cautions. Both parties have agreed to unify corporate income tax rates. Government is committed to implement drastic tax reform measures that may have far reaching implication.

August 31, 2004

Mr. Ganhuleg Baldan, Senior Official, General Department of National Taxation

Excise duties could be extended to some luxuries items such a fur, expensive electronic appliances, and second hand cars. It has been difficult to control leakage in excise on alcohol. There are 180 alcohol producing plants. They have to pay 80 percent of excise revenue at the time of purchase of excise stamps which are affixed in the bottle of alcohol and 20 percent when they buy another lot of stamps. While excise stamps are printed by the government through a printing house with some secret signs, but duplicate stamps have been produced abroad to evade excise duties. While tax administration has been carrying out audits and checks of alcohol producing industries, it has been very difficult to check the misuse of stamps.

Mr. Tsogt Ochirjantsan, Senior tax Official, Training Centre, General Department of National Taxation

Tax Training Centre organizes training programs for tax officials and tax education for the taxpayers. It has three instructors responsible for training, one official responsible for tax education and one director. The centre organizes three levels of training program: initial, intermediary and advance. There is a huge need for training. Mongolia has completed its transition. Now it is necessary to look for new things. For this tax collectors need to be trained on new ideas and new techniques. Some of them should be sent abroad for advance training.

Training centre receives many questions from taxpayers including from foreign investors regarding taxation. But they cannot answer because there have not been many provisions in the law itself. Some taxpayers take undue advantage of this limitation of the law. There are many recommendations given by foreign experts. But nothing has been implemented. There is a need of foreign experts that can prepare implementation plan and work with tax officials.

Problems of taxpayers are collected and circulated to each tax office. Second week of May each year is celebrated as a taxpayers week.

September 1, 2004

Mr. Ganhuleg Baldan, Senior Official, General Department of National Taxation

There is a need to amend tax laws, particularly corporate income tax law and personal income tax law drastically and VAT law partially. It will be necessary to organize several training programs in order to train tax officials on the new amendments and other aspects of tax system and tax administration. Preparation of tax manuals etc. would facilitate the work of tax administration significantly. Tax administration would require technical assistance in these areas.

September 14, 2004

Trainer Mr. Simon Keith and Ms Doljinsuren Jambal and 11 participants of training on immovable property tax organized by ADB.

Immovable property tax law is too short and does not include many provisions. This law does not give power to the tax inspector to assess immovable property tax on the basis of market

value. Property owners declare very low value for the purpose of tax. There is a need to create a valuation office within the tax administration in order to solve the valuation problem. Registry office does not automatically send the information to the tax office regarding the changes in the ownership of the property. Tax administration has started conducting property survey and issuing certificate of each property. There is a lot of scope to generate more revenue from this source.

September 15, 2004

Mr. Luvsandash Zorig, Director General, General Department of National Taxation

Tax administration has been computerized through out the country under the World Bank assistance. There is a need to reform training frame work, which is being done through the JAICA support. There is also a need to reform the legal system. The government has requested IMF for this. Tax administration would like to work closely with the EPRC on several tax issues. Large entities complain that they have to pay high CIT and social security contribution. Medium size companies complain about high rate of VAT. Royalties are too low; their collection has also been a big problem.

There are no big differences among the major political parties regarding tax reform, except the taxation of herders. Some think that herders should be taxed like others while others think that they should be exempted from tax for five years.

September 16, 2004

Ms. Badamtsetseg Lkhamjav, Head of the Data Processing and Automation Division, General Department of National Taxation

Companies are required to submit their tax plans to the tax office for the next income year by August this year. Tax offices, in turn, send these plans to the GDNT. On the basis of these plan budget is prepared for the next year. Individuals who get salary from only one source/employer are not required to file income return. If they have income from more than one source then they have to submit return. CIT refund is made when business is closed. Otherwise it is generally carried forward or adjusted with other tax liability. For the purpose of income tax we have either companies or individuals; there is no concept of proprietorship firm. Dividend tax revenue is not indicated separately.

September 17, 2004

Mr. D. Amarsaikhan, Director, and Mrs. Qyuntileg, Statistician, Statistics and Information Department, Mongolian Customs General Administration

Customs offices are located not only at the border but also in the mainland. Ulaanbaatar Customs office is the biggest customs office that collects about 70 percent of total customs revenue. Large part of revenue comes from the train cargo. Seven large customs offices collect more than 95 percent of the total customs revenue. In 2003, customs administration collected about 30 percent of total tax revenue.

About 30 percent import is exempt from the customs duties. Of this foreign investors imports constitutes about 28 to 32 percent, diplomatic imports and grants constituters about 23 to 27

percent, imports by textiles industries constitutes about 23 to 25 percent and rest is temporary/transit imports.

September 20, 2004

Foreign Investors Group: Mr. Gordon Thorpe, Mr. David Reiner, Mr. Ben Turnbull, Mr. Batbayar Byambaa and Mr. Daniel Mahoney

Tax laws and administrative procedures are not transparent. Some tax provisions do not match with modern tax system and good administrative practices. Tax administrators do not provide VAT refund on time. Tax needs to be paid per month on the basis of budget estimates.

Mr. Tserendashiin Damiran, Member of Parliament Chairman, Standing Committee on Economic Policy

Tax reform measures have to be enacted by the Parliament. There is an agreement among the coalition partners for the uniform CIT rate. High CIT, PIT and social security contributions encourages hidden economy where businesses are encouraged to keep two sets of accounts. Both business community and consumers complain about the high VAT rate as well. Some coalition partners have also been insisting to reduce the customs tariff to zero on some items. Domestic investors complain that foreign investors have been given too many facilities. It is necessary to develop taxpaying culture among the citizen. Another important issue is how to reduce the transportation cost.

September 21, 2004

Mr. Nambariin Enkhbayar, Speaker of the Parliament and former Prime Minister, (Mr. Tuvden Ochirkhuu, Member of Parliament, Mr. Gomboyjav Zandanshatar, Member of Parliament, Mr. Nyamaa Enkhbold Member of Parliament, Mr. Lkhanaasuren Purevdorj Member of Parliament, and Mr. Zandanshatar G. Member of Parliament)

Election results have produced both opportunities and challenges. On the one hand, it would be possible to resolve several social and economic problems jointly which otherwise would be difficult to implement. On the other hand, it is difficult to please every one under a coalition system. There has been discussion on what can be done in the first 100 days and beyond. Some of the areas under discussions are: reducing the number of civil servants, good water management policy, comprehensive tax reform, development of information technology as a part of life, tourism development, and regional development; the most important aspect is how to give poor people a chance to participate in the economy.

September 23, 2004

Dr. S Enkhbaatar, Director, Tax Administration of Ulaanbaatar and Mr. Balsan Ganbold, Department Chairman, The General Department of National Taxation, Tax Collection Division

It is necessary to reform tax system. It is easy to change tax rates but difficult to introduce and implement other measures. There is a need to generate revenue. It is difficult to raise excise rate on alcohol since tax evasion in this area has already been a big problem. VAT rate seems to be high. There is a need to change concept of taxpayer regarding tax.

September 24, 2004

Mr. Badarch Zorig, Manager, Information Technology and Training Center of SSIGO

Social security contributions have been computerized since 1996. Initially data quality was not that good but improved in 2000. A new data base has been created in 2004. Companies send information about the social security contribution. In case of voluntary contributors, social security contribution is levied on the data submitted for the tax purpose. Social security contributions and tax data base is linked.

Mr. Saha Dhevan Meyanathan, Country Manager and Resident Representative, the World Bank

Poverty has been a big problem in Mongolia where 35 percent of the total population is still poor, whose daily income is less than \$ 2 a day and 18 percent of the total population has an income of less than \$ 1 a day. Why have we not been able to reduce the level of poverty? Our efforts should concentrate on this issue.

September 27, 2004

Mr. Bat Erdene Batbayar, Mr. Ganbold D. and Mrs. Delgermaa Banzragchiin, Prime Minister's Advisors

Government is committed to implement comprehensive tax reform package. In general there is no disagreement regarding the reduction of rates of income taxes. Similarly, tax laws will be reformed and tax administration will be strengthened.

Mrs. Pamela J. Slutz, US Ambassador, Mr. Mark A. Tokola, DCM, Mr. Leon Waskin, USAID Mission Director, and Jeff Goodson, Senior Program Manager USAID

It is necessary to concentrate on tax reform. Anomalies in the tax system should be avoided. Tax system should be made simple, transparent and investment friendly. Attempts also need to be made to reduce corruption.

September 28, 2004

Mrs. Batjargal, officer in the Administrative Department and Mr. Tsendeehuu, officer in the Income and Financial Department, State Social Insurance General Office

Social security contributions are directly deposited to the respective fund. They can not be transferred from one fund to another. Contributions, are exempt from income tax.

Mr. Nambariin Enkhbayar, Speaker of the Parliament and Former Prime Minister, (Mr. Nyamaa Enkhbold, Members of Parliament , Mr. Lkhanaasuren Purevdorj, Members of Parliament and Mr. Zandanshatar G. Members of Parliament)

There is a political commitment for the tax reform. A working committee on tax reform consisting of some MPs, representative from the Ministry of Finance and tax administration

will be set up under the convenership of MP Mr. Nyamaa Enkhbold. Budget will be presented to the Parliament on October 1, which must be approved by December 1. Tax proposals can be submitted by parliamentarians during second hearing which will take place around November 1.

September 30, 2004

Mrs. Zagdsuren Mishiglunden, Tax Officials and Mr. Badral Bold, Exchange of Information, General Department of National Taxation

Ministry of Finance and Economy demands the GDNT revenue estimates for the next year, GDNT, in turn, demands it from the tax offices and tax offices demand such estimates from large taxpayers. On the basis of the estimates submitted by the large taxpayers, a payment schedule is prepared for the next year for the large taxpayers, which are required to pay tax each month according to this schedule. Adjustments are made at the end of the year. This process has not been regulated by any tax law.

Allowances provided for transportation, food etc. are not deductible for assessing CIT of employers but not included in the taxable income of employees. While social security contributions are exempt from income taxes, pensions are taxable.

October 4, 2004

Mr. Yondongiin Purevtseren, Head, Monitoring and Evaluation Department, State Social Insurance General Office

Until 1990, pension was paid from the state budget. In 1990, social security contribution law was introduced. In 1991, A Pension Fund was established. At that time the rate of pension premium was 13.5 percent. A new law on Social Insurance was passed in 1994, which came into effect from January 1, 2005. This law introduced the new package of insurance in the form of pension, benefit, health, disability and unemployment.

Social insurance funds are run by the state. They cannot invest their surplus in a productive way. While those who are born after January 1, 1960, will have personal account, the contribution has been deposited to the general budget. Many provisions relating to social insurance have not been implemented.

ANNEX K: REVIEW OF REPORTS ON MONGOLIAN TAX SYSTEM AND ADMINISTRATION

ANNEX K: REVIEW OF REPORTS ON MONGOLIAN TAX SYSTEM AND ADMINISTRATION

#	Author and Title	Recommendations / Summary
1.	<p>"Current Issues in Mongolia Tax Policy"</p> <p>Arthur Mann USAID/DAI, May 2000</p>	<ul style="list-style-type: none"> • CIT rates structure should be reduced from 15% and 40% to 15% and 30% • Loss carry forward provisions should be incorporated into the CIT • Introducing a 2% gross assets tax to enhance revenue collection and shore up administrative deficiencies • Introducing tax legislation regarding thin capitalization and transfer pricing that will also aid in strengthening the administration of the CIT • The top PIT rate should be reduced to 30%, and taxable income brackets indexed for future inflation. • Draft legislation to broaden the GDNT's enforcement powers to encompass the temporary closure and/or seizure of assets without recurring to a lengthy judicial process in the cases of both tax arrears and tax fraud. • Adjust the penalty amounts upwards and subsequently index for inflation. • Strengthen efforts to train and/or retrain judges in modern tax law. Study the possibility of setting up courts specialized in taxation. • Elimination of minor exemptions and the strengthening of various aspects of VAT administration • Elaboration of auditing and auditor productivity indicators • Reinstate the excise tax on all beers. • Raise excise taxes on wine and cigarettes. • Raise and modify the specific base of excises on motor vehicles. Cylinder capacity represents an indisputable criterion, and valuation is easy to verify using catalogues or information available on the internet. Given this latter reality, the tax base can feasibly be converted to vehicle value and the excise applied at ad valorem rate • Upwardly adjust the present monthly absolute amounts by percentages slightly less than the inflation that has occurred since 1997. • Develop procedures and mechanisms to incorporate additional hard-to-tax groups (e.g., professionals) into the tax net; e.g., obtain names of self-employed professionals from professional and business association membership lists. • Proceed with already initiated efforts to develop and prepare draft legislation concerning a structures (buildings) tax.
2.	<p>"Tax Administration in Mongolia"</p> <p>Daniel R. Dietz USAID/DAI April 6, 2001</p>	<ul style="list-style-type: none"> • Preparation of Regulations to state the GDNT's interpretation and explanation of the tax laws for the benefit of the public and the tax inspectors. • Establish a Technical Coordinator position within Headquarters, preferably in the Tax Research and Methodology Division coordinates the writing of the Regulations, Rulings, and Technical Advice • Establishment of a Training Center in an academic environment using professional instructors and a curriculum of courses specifically targeted to the GDNT's needs • Strengthen the Large Taxpayer Unit, giving it complete autonomy to control the 100 largest taxpayers in Audit and Collection and add 5 more inspectors to this Unit • Train the LTU inspectors first • Re-establish the Customer Service position within the LTU • Create a Foreign Technical Advisor position to work with the LTU as a counterpart to the Head of that Unit and to assist in coordination of Regulations and Rulings • Consolidate all the tax laws into one Tax Code
3.	<p>"Mongolia: Improving Strategic Management, Information Flows and the Operation of the Large Taxpayer Office" Graham</p>	<ul style="list-style-type: none"> • Develop a structured approach to identifying information needs across all areas of the GDNT. • Ensure that there is proper separation of the design and delivery functions of the GDNT through organizational structure changes and appropriate job specifications. • Establish a new division at headquarters to oversee and support the field operations. The division to report to the deputy director general.

	<p>Holland and Sandor Somodi, IMF, September 27, 2002</p>	<ul style="list-style-type: none"> • Reassign the reporting line of the internal audit unit so that it is directly accountable to the Director General. • Establish a strategic planning unit within the resource management division. • Adopt a full-fledged LTO operation and organizational structure • Delegate the head office functions currently being managed in the LTO to the new headquarter based field operations review division • Ensure proper staffing to the LTO in accordance with the best international practices • Review the criteria for the selection of the large taxpayers to ensure that the client base consists of those taxpayers that collectively contribute at least 60 percent of total centralized revenue. • Revise the mission statement to properly reflect the GDNT's role. • Consider the development of a vision statement for the GDNT. • Develop a procedure to involve staff from all levels in the revision and development of the strategic statement and direction. • Review the key strategic objectives to ensure that they are achievable, capable of measurement and that they are states as simply as possible. • Establish a project team to coordinate the development of management information needs. • Ensure that managers are aware of the information capability of the information processing system and involve them in the redesign of the management information system.
<p>4.</p>	<p>“Mongolia VAT Assignment” Final Report</p> <p>Analysis and Recommendations</p> <p>Brian Wurts, USAID/DAI</p> <p>May 5, 2003</p>	<ul style="list-style-type: none"> • Shifting the responsibility of paying refunds to the GDNT from the Ministry of Finance, and the creation of a reserve account within GDNT to budget for future refunds of VAT • Changes to the VAT Law be made to specify more clearly the conditions when VAT refunds will be paid out. Refunds to be paid to “Priority Refund Claimants” (primarily large-refund exporters) promptly each month, and to other taxpayers once they have been in an excess credit position for 6 consecutive months • VAT Law be amended to clarify that voluntary registration by businesses with under 10 million Tugrigs in sales is permitted; and start-up businesses be permitted to register and be subject to the normal rules for claiming refunds • Imposing a 2% tax on the gross taxable sales revenues of unregistered small businesses, with sales above 5 million Tugrigs, in order to reduce the differential tax treatment between those businesses just over the threshold, and those below the threshold • As a general rule, no credit be given to newly registered businesses for the VAT incurred on inventories or capital prior to registration. However, a special transitional rule is proposed for new registrants in say, an initial period of 6 months, to permit credits to start-up businesses that would have registered if they had been allowed • Group registration be permitted, where one entity in a related group would be permitted to register on behalf of all the entities. However, to qualify for this treatment, all the entities in the group would have to be entitled to claim full input credits (e.g., no financial institutions or other entities making exempt sales could qualify) • Rules governing the conditions that taxpayers could apply to be deregistered, and the GDNT could deregister a taxpayer when it falls below the threshold • Continue the exemption residential rent, but deny input credits for expenses by the landlord. • Reconsider the procedure for exempting imports by ODA project contractor • The tour operator exemption is to be limited to tours purchased and paid for outside Mongolia (e.g., sales of Mongolian tour packages sold by agents in Japan). • Apply three-step allocation method instead of current revenue-based method to compute the input credits claimable by businesses under VAT • Automobile dealers should be entitled to input credits for their

		<p>acquisitions of vehicles.</p> <ul style="list-style-type: none"> • Regarding the VAT treatment of gifts, promotional goods and samples, GDNT should review its treatment of free promotional goods, and should consider not applying VAT on samples given away, nor for items given away as part of a “buy one, get one free” pricing policy. • Reconsider penal provisions. • Increase the number of tax officers specialized in VAT, and create a VAT sub-unit in the GDNT responsible solely to deal with VAT issues; • The establishment of a separate VAT audit group in the tax offices, which would focus on single-issue VAT audits
5.	<p>“Competitive Position of Mongolia’s Mineral Sector Fiscal System: in the case of a Model Copper Mine”, James Otto, Colorado University, Boulder July, 2003</p>	<ul style="list-style-type: none"> • Lowering the corporate income tax rate • Extension of time duration of loss carry forward preferably for unlimited time or to no less than 5 years • Allow mines to set-aside in a non-revocable condition to cover their reclamation costs • Allow a 200% allowance for exploration (100% of the cost to be expensed as incurred with carry forward, and 100% to be amortized using the existing 5 year straight-line method) • Allow defined percentage up to 0.75% of a company’s taxable revenue spent on government approved public infrastructure to be allowed as a tax credit • Ring fence each mine that is subject to a stability agreement • Consideration to expanding the list of mining equipment as qualifying for exemption under Article 21.1 of the Customs Tariff Law • Exempt mining inputs from the VAT expanding the list of mining equipment as qualifying for exemption under Article 9.2 of the VAT Law. In addition, contracted services for base metals mines should be exempted from VAT under Article 9.1 of VAT Law during the period extending from issuance of the mining license till the start of commercial production. • Lowering the rate of a dividend with holding tax to between 5 and 15% • VAT refunds should be payable in a timely manner • Address the conflicting problem between Article 63 of the Minerals law (specifics of finance and accounting in the mining industry) that is not recognized as applicable by the GDNT.

<p>6. "Reform of the Mongolia, Corporate Income Tax" Richard Krever, USAID/DAI, September 2003</p>	<ul style="list-style-type: none"> • The PIT and CIT tax bases for income other than employment income should be aligned. • The CIT progressive rate scale should be replaced with a single rate. • If a progressive CIT rate scale is retained, consolidation rules should be adopted to combine the taxable income of "group companies" before applying the rate scale. • A seven year loss carry-forward rule is adopted for all taxpayers. • The CIT law should be amended to achieve a format and structure consistent with modern CIT laws. • The CIT should adopt a comprehensive definition of legal persons and other economic or legal structures (e.g., partnerships, trusts, governments) to which the law applies. • The CIT should contain a definition of a "resident" and a "non-resident" taxpayer. The definition can be based on the definition used in Mongolia's double tax agreements. • The provision including non-resident companies in the CIT should be modified to make it clear that the inclusion is only in respect of their Mongolian –source income. • The distinction between gross income and taxable income as different bases for non-residents should be clarified. • The law should provide comprehensive rules explaining how the taxable income of a permanent establishment is calculated. • The tax on income subject to the 20% rate imposed on gross income should be collected by means of a withholding tax regime. • The law should allow the GDNT to substitute arm's length pricing between unrelated parties whenever a transaction between related parties is carried out at a different price. • A foreign tax credit regime should be adopted to provide resident taxpayers with credits against Mongolian tax for foreign taxes imposed on foreign-source income. • The CIT should provide relief from compounding taxation where after-tax profits pass through a chain of companies either by way of an exemption for inter-corporate dividends (other than dividends paid to non-resident companies) or a tax credit for tax imposed on such dividends. • The CIT should contain a distribution ordering rule preventing distributions of capital before all retained earnings have been distributed (a distribution "ordering" rule). • A comprehensive definition of dividend should be adopted to include distributions of profits through off-market share buybacks, share cancellations, indirect provision of benefits, and liquidation distributions. • If the tax on inter-corporate dividends flowing to resident companies is removed, anti-avoidance provisions should be drafted to ensure no tax-free flow through is available for dividend payments on equity arrangements that are equivalent to debt. • Consideration is given to adopting a 3:1 debt-equity ratio for non-financial institutions and a 6:1 ratio for financial institutions. • A consistent tax rate should apply to all interest income. • Complementary incorporation rollover provisions should be inserted in the PIT and CIT laws sole proprietors and other unincorporated businesses to incorporate without facing an immediate tax consequence. • Consideration is given to the preparation of corporate reorganization provisions dealing with basic corporate reorganizations including share-for-share exchanges.
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7.	"Growth and Recovery in Mongolia During Transition" Kevin C. Cheng, IMF, November 2003	<ul style="list-style-type: none">• As in most former socialist countries, while capital accumulation appears to have been the primary factor accounting for growth prior to the establishment of a market system, efficiency gains became the main source of growth during the early stages of transition;• Mongolia, like most other transition economies, experienced a painful, initial "transformational recession" before the economy began to recover;• Mongolia's adjustment process has been smooth compared with other transition economies and has been less costly in terms of output loss than those of countries of the Soviet Union that have similar geographic and historical features; and• While Mongolia's relatively strong output performance can be partly explained by favorable economic and non-economic initial conditions, the early adoption of appropriate adjustment policies and market-oriented reforms is likely to have played a key role in supporting the prompt recovery of growth
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ANNEX L: SELECTED REFERENCES

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**ANNEX M: TAX RELATED LAWS, REGULATIONS, ORDINATIONS AND
DECREES**

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No	Title
1	The Constitution of Mongolia , January 13, 1992
2	Law on the Government of Mongolia , May 6, 1993
3	General Taxation Law , November 23, 1992
4	Business Entities Income Tax Law , December 14, 1992
5	Personal Income Tax Law , December 14, 1992
6	Law on Fees for Hunting Resource Utilization and Fees for Obtaining Special Permission for Hunting and Fishing , May 22, 1995
7	Law Fees for Timbering and Timber Utilization , May 19, 1995
8	Law on Fees for Water and Natural Water Resource Utilization , May 22, 1995
9	Law on Fees for Natural Plant Utilization , May 19, 1995
10	Minerals Law of Mongolia , June 5, 1997
11	Law on Personal Income tax Flexible Due to Specifics of Work or Private Entrepreneurship , November 22, 2001
12	Law on VAT , January 8, 1998
13	Law on Procedures for Implementation of the Law on VAT , January 08, 1998
14	Law on Excise Tax , January 21, 1993
15	Law on Tax Imposition, Payment Monitoring and Tax Collection , May 2, 2002
16	Law on Civil Service , December 19, 1997
17	Public Sector Management and Finance Law , August 8, 1998
18	Partnership Law , May 11, 1997
19	Cooperative Law , January 8, 1998
20	Company Law , July 2, 1997
21	Law on Customs Tariff , May 20, 1996
22	Law Determining the Amount of Export Duty to be Imposed on Certain Commodities , March 29, 1996
23	Gasoline and Diesel Fuel Tax Law , June 2, 1995
24	Transport Facilities and Vehicles Tax Law , December 1, 1992
25	Fire Arms Tax law , May 11, 1993
26	Immoveable Property Tax Law , November 17, 2000
27	Law on Stamp Duties , July 17, 1993
28	Law on Land fees , April 24, 1997
29	Law on Expenditure Rate from Natural Resource Utilization Income for Environment Protection and Rehabilitation , January 28, 2000
30	Law on Licensing , February 1, 2001
31	Law on Rights and State Registration of other Rights Relevant to Capital Ownership , June 19, 2003
32	Government Resolution of Mongolia , May 7, 1997, # 119, Some of the implementation measures of the General Taxation Law of Mongolia /National Taxation Agency Regulation
33	Parliament Resolution , February 6, 1997, # 19, Some implementation measures for the law
34	Government Resolution of Mongolia , June 26, 2001, # 140, on adoption of list / the list of priority Sectors for foreign investment

35	Government Resolution of Mongolia , November 17, 1999, # 189, Enacting the regulations / Tax dispute solution regulations
36	Government Resolution of Mongolia , January 1, 2001, # 14, Enacting the regulation on using cash register
37	Government Resolution of Mongolia , June 3, 1999, # 27, on Adoption of Percentage and scale of import customs duties
38	Government Resolution of Mongolia , October 26, 2001, # 245, on Adoption of Regulation/ Regulation on customs duties exemption, deduction or refund
39	Government Resolution of Mongolia , September 4, 2002, # 177, on Adoption of Regulation and Setting payment amount/ Regulation on traffic utilization fees to be imposed on vehicles traveling on international or national auto roads or constructions -Annex 1, The amount of fees to be imposed on vehicles traveling on international or national auto roads or constructions - Annex 2
40	Government Resolution of Mongolia , October 13, 1995, #163, on Adoption of renewed amounts of fees/ Amount of fees to be imposed for Timbering and Timber Utilization
41	Government Resolution of Mongolia , August 25, 1995, # 163, on Adoption of amounts of fees
42	Supreme Court Resolution of Mongolia , March 25, 2002, #100, Commentaries on some of the Tax law articles and chapters
43	Ordinance of the national Tax Administration Chief , May 14, 2001, # 83, enacting the regulations / Tax administration functions, including the forms /- annex 1, evaluation and monitoring regulations of Capital city, aimag, district and other large taxpayers activities- annex 3
44	Ordinance of the National Tax Administration Chief , May 16, 2001, # 85, Enacting regulations, forms and patterns / stamp use regulations for the state tax inspector – annex 1
45	Ordinance of the National Tax Administration Chief , June 25, 2001, # 117, Enacting the regulations/procedures when exchanging information with the Tax agencies of foreign countries
46	Ordinance of the National Tax Administration Chief , July 31, 2001, # 145, Enacting regulations/ regulations for appointing a state tax inspector
47	Ordinance of the National Tax Administration Chief , September 19, 2002, # 175, Enacting regulations/ The etiquette of state tax inspector
48	Ordinance of the National Tax Administration Chief , July 4, 2003, # 142, Enacting regulations/regulation on investigating and resolving complaints about tax payers and tax inspector
49	Ordinance of the Tax Administration Chief , June 10, 1996, # 69, Enacting the regulations / regulations on resolving the complaints and requests made by citizens
50	Ordinance of the National Tax Administration Chief , September 11, 2003, # 174 Enacting a temporary regulation on using the stamps
51	Ordinance of the Minister of Finance and Economy of Mongolia , December 6, 2001, # 379 Enacting regulations /Using tickets-annex 1, pattern of tickets-2,3 annexes
52	Ordinance of the National Tax Administration Chief , August 1, 2001, # 147 Instructions for using cash register, filling out the forms/cash register manual-annex 1, taking notes of the cash register counter and nulling the cash register- annex 2, Sending the cash register for repair or the counter notes when returning the cash register- annex 3, maintenance record keeping- annex 4
53	Ordinance of the National Tax Administration Chief , July 24, 2001, # 143 Enacting the regulations/registering state budget subsidy organization-annex 1, state registration form-annex 2
54	Ordinance of the National Tax Administration Chief , November 1, 1999, # 164 Rewriting and enacting of regulations/regulations on registering firm, company, state owned public agencies, corporative and partnerships
55	Joint Ordinance of the National Tax Administration Chief and the Chief of General Police Department , September 26, 2002, # 181/ 348 Enacting regulations/regulations on re-directing criminal acts against tax collection to the organ of enquiry

56	Ordinance of the State Tax Administration Chief , January 18, 1997, # 19, Enacting regulations /record keeping of state budget income deposit
57	Ordinance of the National Tax Administration Chief , January 7, 1999, # 3, Registration number for the state tax inspector
58	Ordinance of the National Tax Administration Chief , January 26, 1999, # 19, enacting of the form/tax payer profile
59	Ordinance of the National Tax Administration Chief , June 29, 2001, # 119, Enacting of regulations and forms
60	Ordinance of the National Tax Administration Chief , July 16, 2001, # 134, Enacting the regulations
61	Ordinance of the National Tax Administration Chief , January 25, 2001, # 17, Enacting the regulations, registration of the local tax revenue collection to the state central tax budget
62	Ordinance of the National Tax Administration Chief , May 28, 2002, # 111, Enacting the regulations, establishing a fund for public dialogue
63	Ordinance of the National Tax Administration Chief , December 10, 2002, # 219, Enacting the regulations, forcing legal entity to pay taxes
64	Ordinance of the Minister of Finance and Economy , September 20, 2002, # 272, Enacting the regulations, sending a Notice and collecting taxes
65	Ordinance of the National Tax Administration Chief , June 17, 2003, # 125, State tax inspector's report and conclusions
66	Ordinance of the National Tax Administration Chief , January 10, 2002, # 2, Enacting a methodology
67	Ordinance of the National Tax Administration Chief , April 23, 2002, # 80, Making changes to the methodology
68	Ordinance of the National Tax Administration Chief , June 28, 2002, # 128, Enacting the forms and instructions /fuel, gas sales tax form TT-23-annex 3, royalty tax form TT-15-annex 5
69	Ordinance of the National Tax Administration Chief , March 27, 1998, # 39, Enacting the regulations /depreciation contract
70	Joint Ordinance of the National Tax Administration Chief and the Chief of the State General Customs Administration , December 23, 2003, # 707/227, Enacting the regulations, instructions and amount of the tax/ deducting and collecting taxes from legal entities that process and export raw materials from the territory of Mongolia- annex 1
71	Ordinance of the National Tax Administration Chief , November 24, 2003, # 210, Enacting the regulations /checking the tax payer's capacity, and monitoring their actual
72	Ordinance of the National Tax Administration Chief , January 21, 2002, # 21, Enacting the methodology of the income tax law implementation
73	Ordinance of the National Tax Administration Chief , June 29, 2002, # 129, Enacting the regulations and forms /Registration of tax personal income tax payers and tax collection/-annex 1, Personal income tax form #TT-06-annex 2, standard tax statement form #TT-07-annex 3, herdsman's tax form #TT-08-annex 4, tax deduction form#TT-11-annex 5, contractor tax form#TT-12-annex 6, personal real estate sales tax form#TT-14-annex 10
74	Decree of Director of National Taxation General Administration , April 20, 2001, # 67, on Adoption of procedure form/ Registration of tax-payers of immovable property (TB-4 form) - Annex 1, Amendments to Registration of immovable property tax-payers (TB-4 A form) -Annex 2, Summary Report on listing of immovable properties and evaluations thereof (Summary Report-TB4) -Annex 3, Database of registered immovable property tax-payers (Summary-TB4) - Annex 4
75	Decree of Minister of Finance and Economy of Mongolia , March 1, 2002, # 55, on Adoption of methodology/ methodology for comparative estimations of taxable income of citizens running enterprises or works and services, which are not subject to regulation under specific enterprise, organization or individual contracts or agreements
76	Decree of Director of National Taxation General Administration , December 17, 2001, # 223, on Adoption of stamp duties report form

77	Decree of Director of National Taxation General Administration , March 2, 2001, # 44, on Renewal of Form /Certificate of tax payment for Personal Income Tax Flexible Due To Specifics of Work or Private Entrepreneurship-Annex 1, Guidelines for completing the Certificate-Annex 2
78	Decree of Director of National Taxation General Administration , December 18, 2002, # 228, on Adoption of methodology/ methodology for estimations and taxation of income of citizens running individual retail sale
79	Joint Decree by Director of National Taxation General Administration and Director of Environment Protection Department , January 15, 2002, # 07/02, on Adoption of Regulation/ Regulation on supervision of implementation of the Law on Expenditure Rate from Natural Resource Utilization Income for Environment Protection and Rehabilitation
80	Joint Decree by Ministers of Finance and Economy and Industry and Trade of Mongolia / 26 October 2001/ #307/112/ on Adoption of List / the List of equipment to be assembled, installed and used for technological purposes by enterprises with foreign investment, investing and operating in the priority sectors
81	Decree of Director of National Taxation General Administration , April 20, 2001, # 67, on Adoption of procedure form/ Resolution of the Government of Mongolia, December 5, 2001, #264, on Adoption of List, Evaluation, Payments and Fees / List of Rare animals -Annex 1, Amount of Fees for Hunting Resource Utilization and fees for obtaining special permission for hunting and fishing -Annex 2, Comparative pricing and fees for special permission for foreign residents' hunting -Annex 4
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83	Decree of Minister of Finance and Economy of Mongolia , December 27, 2002, # 411, on Adoption of procedures/ procedures to be reflected in the initial stage of VAT accounting
84	Decree of Minister of Finance and Economy of Mongolia , April 16, 2003, # 148, on Amendment to the procedures
85	Decree of Director of National Taxation General Administration , December 22, 1995, # 120, on Adoption of Report template for payments and fees / Report Template on Fees for Timbering and Timber Utilization (TA-18) -Annex 1, Template of water utilization fees (TA-19) -Annex 2, Template report on springs and natural water utilization fees (TA-20) -Annex 3, Template report on natural plant utilization fees (TA-21) -Annex 4, Template report on Fees for Hunting Resource Utilization and fees for obtaining special permission for hunting and fishing (TA-22) -Annex 5, Template summary report on Fees for Hunting Resource Utilization and fees for obtaining special permission for hunting and fishing executed by taxation offices of soums, districts, aimags and the capital (TA-23) -Annex 6
86	Decree of Director of National Taxation General Administration , February 26, 2002, # 37, on Adoption of methodology / methodology for calculations of VAT deductions
87	Decree of Director of National Taxation General Administration , August 1, 2003, # 161, on Adoption of regulation / Regulation on monitoring and verification of VAT imposition and payment-Annex 1, Form of Certificate of verification of VAT imposition and payment-Annex 2
88	Decision by Council Directorate of National Taxation General Administration , December 20, 1995, on Methodology for implementation of the Law on Fees for Water and Natural Water Resource Utilization
89	Decree of Minister of Finance and Economy of Mongolia , January 4, 2002, # 3, on Adoption of Standard price/ the minimum pricing limit for excise tax estimation of vodka to be applied for enterprises and breweries engaged in production of alcohol/wine
90	Decision by Council Directorate of National Taxation General Administration , December 20, 1995, on Methodology for imposing and assembling fees for Water and Natural Water Resource Utilization to the state budget

91	Decree of Director of National Taxation General Administration, May 15, 2001, # 84, on Adoption of regulation/ Regulation on confiscation of alcohol and tobacco without banderol or with counterfeit banderol -Annex 1, Noting alcohol and tobacco confiscation (TA-1 form) -Annex 2, Documentation of transfer of alcohol and tobacco to the Deposition Commission (TA-2 form)-Annex 3, Documentation on deposition of confiscated alcohol and tobacco (TA-3 form) -Annex 4, Documentation on verification of deposition execution (TA-4 form) -Annex 5, Registration of confiscated alcohol and tobacco (TA-5 form) -Annex 6, Report on alcohol and tobacco confiscation (Report-1) -Annex 7, Information on confiscated and/or destroyed alcohol and tobacco (Summary report-2) -Annex 8
92	Decree of Director of National Taxation General Administration, July 23, 2002, # 151, on Adoption of procedures and form/ sample of Specification of counting, banderol allotment and collection of payment thereof applied to imported alcohol and tobacco and domestically produced tobacco (Form 1) -Annex 1, Expenditure report form of Specification of calculation of banderol allotment and collection of payment thereof applied to imported alcohol and tobacco and domestically produced tobacco -Annex 2, Table on calculation of imported alcohol and tobacco -Annex 3, Table of calculation of imported alcohol and tobacco and domestically produced tobacco -Annex 4, For of summary report on calculations of alcohol and tobacco of individuals, enterprises and organizations of aimag, the capital city, soum and district -Annex 5
93	Joint Decree by Director of National Taxation General Administration and Director of National Customs General Department, August 26, 2003, # 159, 446, on Adoption of Regulation/ Regulation on information exchange on excise tax and excise tax banderol for imported alcohol and tobacco
94	Decree of Director of National Taxation General Administration, June 18, 2003, # 128, on Adoption of Form and Model/ Report on excise tax and excise tax banderol for alcohol beverages -Annex 1, Model for reporting -Annex 2, Report on excise tax and excise tax banderol for tobacco -Annex 3, Model for reporting -Annex 4, Model for reporting on transfer of alcohol excise tax banderol -Annex 8, Model for reporting -Annex 10 -(selected quotation)
95	Decree of Director of National Taxation General Administration, June 18, 1994, # 59, on monitoring and supervision of income and tax of individual traders
96	Joint Decree by Director of National Taxation General Administration and Director of National Customs General Department, October 1, 1996, # 109,292, on Adoption of Regulation/ Regulation on exchange and utilization of information on taxation
97	Joint Decree by Director of National Taxation General Administration and Director of National Customs General Department, December 6, 1994, # 113,293, on Taxes to be imposed on enterprises involved in export of raw materials of animal origin
98	Decision by Council Directorate of National Taxation General Administration, April 5, 2001, on Methodology for implementation of the Immovable Property Tax Law

Source: "Collection of Legislation Acts on Taxation" by the Ministry of Justice and Interior, National Legal Center and General Department of National Taxation.